PB86-139276

EPA's (Environmental Protection Agency) Implementation of the Federal Managers' Financial Integrity Act

(U.S.) General Accounting Office, Washington, DC

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In response to continuing disclosures of fraud, waste, abuse, and mismanagement in federal programs, the Congress enacted the Federal Managers' Financial Integrity Act (FMFIA) of 1982. By requiring agencies to evaluate and report on their internal control and accounting systems, the act provides the necessary discipline for agencies to identify, remedy, and report on internal control and accounting systems problems that hamper effectiveness potentially cost taxpayers billions of dollars, and erode public confidence in government. The Environmental Protection Agency (EPA), with about a $4.3-billion budget for fiscal year 1985, manages the national effort to protect public health and the environment by regulating various areas-air, water, pesticides, toxic substances, and hazardous waste.

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United States General Accounting Office

GAO

Report to the Administrator of the Environmental Protection Agency

November 1985

EPA-FMFIA

EPA's Implementation of the Federal Managers' Financial Integrity Act

GAO/RCED-86-34

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United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-216946

November 13, 1985

The Honorable Lee M. Thomas
The Administrator of the
Environmental Protection Agency

Dear Mr. Thomas:

This report presents the results of our review of the Environmental Protection Agency's implementation of the Federal Managers' Financial Integrity Act of 1982. Our review was part of GAO's government-wide assessment of the act's second-year implementation by 23 agencies.

This report contains recommendations to you in chapters 2, 3, and 4. As you know, 31 U.S.C. §720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and to the House Committee on Government Operations not later than 60 days after the date of the report, and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget; appropriate congressional committees; and other interested parties.

Sincerely yours,

J. Dexter Peach
Director

Executive Summary

In response to continuing disclosures of fraud, waste, abuse, and mismanagement in federal programs, the Congress enacted the Federal Managers' Financial Integrity Act (FMFIA) of 1982. By requiring agencies to evaluate and report on their internal control and accounting systems, the act provides the necessary discipline for agencies to identify, remedy, and report on internal control and accounting systems problems that hamper effectiveness, potentially cost taxpayers billions of dollars, and erode public confidence in government.

The Environmental Protection Agency (EPA), with about a $4.3-billion budget for fiscal year 1985, manages the national effort to protect public health and the environment by regulating various areas—air, water, pesticides, toxic substances, and hazardous waste.

In evaluating EPA's implementation of the act, GAO examined

- improvements in internal controls and the process used by EPA to evaluate and correct control weaknesses,
- the status of EPA's accounting system and evaluations made to determine whether it conforms to the Comptroller General's requirements, and
- the accuracy and completeness of the Administrator's annual report to the President and the Congress on EPA's internal controls and accounting system.

Background

The act requires all federal agencies to establish, in accordance with standards prescribed by the Comptroller General, controls that reasonably ensure obligations and costs are in compliance with applicable law; assets are safeguarded against fraud, waste, and mismanagement; and revenues and expenditures are properly recorded and accounted for. (See p. 8.)

Agency heads must report to the President and the Congress annually on whether their internal control systems comply with the act's objectives and, to the extent systems do not comply, identify material weaknesses in their systems, together with plans for corrective actions. They also must report on whether their agencies' accounting systems conform to the Comptroller General's accounting principles, standards, and related requirements. (See p. 9.)

The Office of Management and Budget (OMB) also published guidelines that require managers to analyze programs and functions to determine

their vulnerability to waste, fraud, and mismanagement. EPA generally follows these guidelines in evaluating and reporting on the status of its controls.

Results in Brief

Although EPA has made progress in evaluating and improving its internal control systems, it needs to strengthen several aspects of its process for evaluating and correcting internal controls.

EPA has taken steps to correct accounting system deficiencies identified in 1983-84. However, it has not sufficiently tested its accounting system in operation.

The Administrator's 1984 annual report stated that EPA's systems, taken as a whole, provide reasonable assurance that its systems of internal controls met the act's objectives and that its accounting system, except for three material weaknesses, conforms to the Comptroller General's principles, standards, and related requirements. However, GAO believes that EPA does not have an adequate basis for these assurances.

Principal Findings

Internal Control Weaknesses

In its 1983 annual report, EPA identified four program-wide material weaknesses. The 1984 report cited 34 actions to correct these weaknesses. Also in 1984, EPA reported five material weaknesses along with corrective actions it plans to take in fiscal year 1985. The weaknesses reported involve programs that encompass most of EPA's budget. One material weakness is the construction grants program that accounts for about 56 percent of EPA's fiscal year 1985 budget.

The 1984 report stated that EPA had corrected 525 of the approximately 727 internal control weaknesses EPA managers identified during 1983 and 1984.

Although EPA's 1984 report contained much information and showed that EPA is progressing in implementing the act, it did not list as material three weakness areas that GAO believes should have been listed; the hazardous waste Superfund and Resources Conservation and Recovery Act areas and weaknesses in automated data processing operations were not adequately identified in the 1984 report. Because of the significance of

material weaknesses at EPA and for other reasons, GAO believes EPA's Administrator did not have an adequate basis to provide reasonable assurance that the Agency's system of internal controls were effective. (See pp. 14-24.)

Evaluating Internal Controls

EPA's 1984 segmentation process excluded various regional programs and functions. EPA's team approach to performing vulnerability assessments lacks adequate program and operating level input to the process. Program managers were not adequately involved in performing assessments, contrary to OMB's emphasis that the internal control review process be self-assessment by responsible managers. (See pp. 26-30.)

Four of the six completed internal control reviews GAO evaluated did not include adequate testing. Some areas of high and medium vulnerability were not scheduled for internal control reviews. (See pp. 30-34.)

Evaluating the Accounting System

GAO believes that EPA has not conducted sufficient analyses and testing to determine whether its accounting system conforms with the Comptroller General's requirements. Specifically, EPA did not (1) develop a formal plan to implement the act's accounting requirements, (2) test its accounting system in operation for conformance, (3) report a material accounting system weakness GAO advised them of, and (4) sufficiently address important principles and standards in its accounting system compliance evaluation. (See pp. 44-57.)

Recommendations

GAO recommends that the Administrator

- list all material EPA internal control weaknesses identified until they are substantially corrected in future annual reports (see p. 22) and
- develop and implement a formal plan to review and test EPA's accounting system in operation. (See pp. 55-56.)

GAO also makes other recommendations to improve the processes EPA uses to evaluate its internal controls and accounting system. (See pp. 42 and 55-56.)

Agency Comments

EPA said many of GAO's recommendations will help strengthen its implementation of FMFIA and that it has already taken steps in 1985 to implement a number of them. (See app. II, and pp. 42-43.)

EPA disagreed with GAO's conclusion that the Agency did not have an adequate basis for reporting in its 1984 report to the President and the Congress that, taken as a whole, it had reasonable assurance on its internal controls and accounting system. EPA believes it has adequate internal controls in place, that the extent of its material weaknesses are not substantial and that its process complies with OMB guidance.

GAO recognizes that management judgment is involved in reaching a conclusion that Agency internal control and accounting systems provide reasonable assurance that the act's requirements have been met. GAO believes, however, that unless the Agency's key accounting systems and internal controls over major programs and functions are adequately evaluated and tested and until the material weaknesses which significantly impair internal controls over important agency functions are substantially corrected, the Agency head does not have an adequate basis to conclude that it has reasonable assurance under the act.

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Abbreviations

ADP	automated data processing
EPA	Environmental Protection Agency
FMFIA	Federal Managers' Financial Integrity Act of 1982
GAO	General Accounting Office
ICC	internal control coordinator
ICPT	Internal Control Project Team
ICR	internal control review
OIG	Office of Inspector General
OMB	Office of Management and Budget
POH	primary organization head
RCRA	Resources Conservation and Recovery Act of 1976
VA	vulnerability assessment

Chapter 1

Introduction

The Congress, in September 1982, enacted the Federal Managers' Financial Integrity Act of 1982 (FMFIA) in response to continuing disclosures of waste, loss, unauthorized use, and misappropriation of funds or assets across a wide spectrum of government operations. The goal of this legislation is to help reduce fraud, waste, and abuse and to improve management of federal operations. By requiring agencies to evaluate and report on their internal control and accounting systems, the act provides for the first time the necessary discipline for agencies to identify and remedy long-standing internal control and accounting systems problems that hamper effectiveness and accountability, potentially cost the taxpayer billions of dollars, and erode the public's confidence in government.

The act reaffirms the concept first embodied in the Accounting and Auditing Act of 1950—the primary responsibility for adequate systems of internal control and accounting rests with management. The Congress has taken a major step forward by requiring for the first time that agency heads report annually on the status of their internal control and accounting systems and by holding managers publicly accountable for correcting of weaknesses.

Our review at the Environmental Protection Agency (EPA) is 1 of the 23 reviews we have made of federal agencies' efforts to implement the act during the second year. In 1984, we issued reports on 22 agencies' implementation of the act during the first year.[1]

Requirements of the Act

Section 2 of the act requires that agency systems of internal accounting and administrative control must comply with internal control standards prescribed by the Comptroller General and must provide reasonable assurances that

- obligations and costs are in compliance with applicable law;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

[1]EPA was not included in our first-year reviews.

Also, section 2 requires each agency head to annually evaluate the systems and prepare a report which states, among other things, whether the agency's internal control systems fully comply with the act's requirements. To the extent systems do not comply, the act requires agency heads to identify any material weaknesses[2] in the agency's systems, together with plans for corrective actions.

Section 4 of the act further requires that the agency head issue a separate report on whether the agency's accounting systems conforms to the Comptroller General's accounting principles, standards, and related requirements.

GAO Standards

To provide the framework for implementation, as prescribed by the law, in June 1983 the Comptroller General issued standards for agencies to meet in establishing their internal control systems. The standards include such things as (1) documenting all internal control systems, transactions, and other significant events, (2) identifying or developing control objectives for each activity within the agency, (3) establishing control techniques that would effectively accomplish internal control objectives, (4) providing proper supervision that would ensure internal control objectives are achieved, and (5) providing reasonable assurance that the objectives of the internal control systems are being accomplished.

The standards apply to program management as well as to traditional financial management areas and encompass all operations and administrative functions. In publishing the standards, the Comptroller General emphasized that:

"The ultimate responsibility for good internal control rests with management. Internal controls should not be looked upon as separate, specialized systems within an agency. Rather, they should be recognized as an integral part of each system that management uses to regulate and guide its operations. In this sense, internal controls are management controls. Good internal controls are essential to achieving the proper conduct of government business with full accountability for the resources made available."

[2]Material weaknesses are defined by the House Committee on Government Operations as those matters that could (1) impair fulfillment of an agency's mission, (2) deprive the public of needed government services, (3) violate statutory or regulatory requirements, or (4) result in a conflict of interest.

OMB Guidance

In 1981, prior to FMFIA, the Office of Management and Budget (OMB) issued Circular A-123. The circular prescribed policies and standards to be followed by the federal executive departments and agencies in establishing and maintaining internal controls in their programs and administrative activities. In August 1983, OMB revised Circular A-123 to incorporate FMFIA provisions. The revised circular requires agencies to set up internal control systems that meet GAO standards, determine whether internal controls are operating as intended, and assure that necessary corrections are made.

As required by FMFIA, OMB, in consultation with GAO, issued guidelines for federal departments and agencies to use in evaluating their internal control systems. These guidelines were issued in December 1982.

OMB's internal control guidelines outline a phased approach for agencies to evaluate, improve, and report on their internal controls:

- Organize the internal control evaluation process, including overall planning and direction, assigning responsibilities, and developing an information system to monitor and track the status of evaluations and corrective actions.
- Segment the agency into organizational units, programs, and functions.
- Assess the vulnerability of the individual segments (assessable units) to fraud, waste, and abuse and decide which segments are most vulnerable to these occurrences.
- Review the internal controls for the selected activities and develop recommendations to correct identified weaknesses.
- Take corrective actions to improve internal controls.
- Prepare the required annual report to the President and the Congress on the status of the agency's system of internal control.

EPA Mission

EPA's programs and responsibilities deal with management of our natural environment to protect the public health and welfare and the environment in which we live. Nine major pieces of legislation direct EPA activities—the Clean Water Act; the Clean Air Act; the Resources Conservation and Recovery Act of 1976 (RCRA); the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (Superfund); the Federal Insecticide, Fungicide, and Rodenticide Act; the Toxic Substances Control Act; the Safe Drinking Water Act; the Marine Protection, Research and Sanctuaries Act; and the National Environmental Policy Act.

EPA's fiscal year 1985 budget was authorized by the Congress at about $4.3 billion—$1.3 billion for operating programs, $2.4 billion for construction grants, and $620 million for Superfund. For fiscal year 1985, EPA was authorized over 11,330 permanent work years.

Most of EPA's operational activities are delegated for implementation to its 10 regional offices and other smaller field locations throughout the country. By law, much of EPA's program activity may be carried out by state and local governments.

EPA Internal Control Program

On February 23, 1984, EPA issued Order 1000.24, which incorporated OMB's internal control guidelines and the Comptroller General's standards. The order sets standards for internal control for EPA program operations and administrative functions and prescribes organizational and functional responsibilities, including requirements for the annual report.

EPA's 1982 process for conducting the internal control evaluation followed the OMB recommended phased approach and involved the Office of Inspector General (OIG) and regional offices. The vulnerability assessments (VAs) completed in 1982 covered 29 assessable units.

In August 1983, a project manager and an Internal Control Review Task Force, later called the Internal Control Project Team (ICPT), were established by the Assistant Administrator for Administration and Resources Management—the official responsible for coordinating FMFIA activities at EPA—to oversee the act's activities. The ICPT was responsible for coordinating and monitoring the Agency's internal control evaluation and improvement activities. The ICPT issued guidelines for implementing the act's requirements.

To assist the regional offices in implementing FMFIA, the ICPT issued guidance memoranda and conducted meetings with regional staff to allow them to ask questions on problems they had with EPA's implementing guidelines and the FMFIA process generally. The meetings were also to serve as training sessions for regional staff on different phases of the process. In late 1984 and early 1985, EPA completed its second round of VAs on 96 assessable units. In 1984, EPA also completed five of seven headquarters internal control reviews (ICRs).

Objectives, Scope, and Methodology

Our objectives were to assess

- improvements in internal controls and the process EPA used to evaluate and correct internal control weaknesses,
- the status of EPA's accounting system and evaluations made to determine whether it conforms to GAO requirements, and
- the accuracy and completeness of the Administrator's 1984 annual report on EPA's internal controls and accounting system.

Our work was done primarily at EPA headquarters, Office of the Assistant Administrator for Administration and Resources Management, and at the EPA regional offices in Atlanta (Region IV), Chicago (Region V), Philadelphia (Region III), and San Francisco (Region IX) and at EPA's Research Triangle Park in Raleigh-Durham, North Carolina. Our review was conducted from June 1984 through February 1985.

Our review covered EPA's first-year as well as its second-year FMFIA efforts. We did not attempt to independently determine the status of EPA's internal control systems or the overall extent to which EPA's accounting system conforms with the Comptroller General's principles, standards, and related requirements.

We reviewed documentation developed by EPA headquaters and the EPA regional offices we visited. We examined 20 of the 96 VAs and the 7 ICRs EPA cited in its 1984 FMFIA annual report. In addition, we reviewed an ICR that was completed in Region V. We also examined 25 of 552 corrective actions reported in the 1983 annual report. We based our review of VAs and corrective actions primarily on random samples we took of the VAs that were completed in 1984 and of the corrective actions EPA planned as a result of its 1983 FMFIA work.

We also reviewed files accumulated during OMB's monitoring of EPA's progress in meeting the act's requirements, as well as copies and extracts of past GAO and OIG reports, special studies, and congressional reports on EPA actions covering fiscal years 1982 and 1983.

In Washington, as well as at the EPA regional offices we visited, we interviewed officials responsible for coordinating the FMFIA process at their respective organizations, staff who carried out the evaluations, and OIG representatives. We discussed the methodologies EPA employed and guidance it provided to staff in performing the evaluations. We also

reviewed written instructions made available to the office or the operating unit where the evaluations were completed and examined supporting documentation and other available records substantiating the evaluations done.

We reviewed EPA's efforts to evaluate controls relating to automated data processing (ADP) operations because of ADP's integral role in EPA activities.

For section 4 work, we examined relevant files to document the process EPA followed to comply with the act. We interviewed EPA officials, including the Director of the Financial Management Division and the agency staff that evaluated their accounting system for conformance with the Comptroller General's requirements. Our purpose was to determine how the section 4 reviews were conducted and what progress had been made.

We conducted accounting system evaluations testing at the two financial management offices in Atlanta, Georgia, and Raleigh-Durham, North Carolina, to determine whether selected aspects of EPA's accounting system were operating according to established accounting principles and standards and whether certain OIG-reported weaknesses had been corrected. We developed and reviewed a random sample of 242 vouchers processed between April 1 and August 31, 1984. (App. I contains a complete description of our section 4 methodology.)

We conducted our work in accordance with generally accepted government auditing standards.

EPA Basis for Reasonable Assurance on Internal Controls

FMFIA requires an annual report by December 31 from each agency head to the President and the Congress as to whether the agency has established systems of internal accounting and administrative control in accordance with guidelines and standards prescribed by the Comptroller General and which reasonably ensure that the three statutory objectives are met. In his December 27, 1983, and December 31, 1984, reports, the Administrator acknowledged that a substantial percent of EPA's operations are highly vulnerable to fraud, waste, abuse, and mismanagement. However, the Administrator provided reasonable assurance that EPA's systems of internal accounting and administrative control, taken as a whole, achieved the three statutory objectives.

In our opinion, the Administrator does not yet have an adequate basis for reporting that he has reasonable assurance on the internal control systems taken as a whole. Our concerns are fourfold:

- Material weaknesses cited by the Administrator in the 1984 FMFIA report involve programs and functions which account for most of EPA's budget.
- The 1984 FMFIA report did not list three areas as material weaknesses which were identified and we believe should have been listed.
- As discussed in chapter 3, there are problems with the effectiveness of EPA's process to evaluate internal controls.
- As discussed in chapter 4, the Administrator did not have an adequate basis for providing reasonable assurance on EPA's accounting system, which in our opinion affects his ability to provide reasonable assurance on internal controls.

The Annual Report Process

OMB guidelines list several elements that should form the basis for an agency head's annual FMFIA report. Some of the elements include considering the documented results from VAs and ICRs, written assurance on the reasonableness of internal controls from the designated high-level officials responsible for directing the FMFIA process, and comments from the Inspector General or equivalent.

FMFIA also requires an agency to include within its report material weaknesses in internal accounting and administrative control and a schedule for their correction. EPA Order 1000.24 reiterates OMB's and the act's requirements and requires an annual report on internal controls from program managers.

EPA, on December 27, 1983, and December 31, 1984, provided the President and the Congress with reports on internal administrative and program controls (section 2) and on accounting system controls (section 4). The annual reports on section 2 are discussed below, while the section 4 reports are summarized in this chapter and addressed more fully in chapter 4.

The Administrator reported four program-wide material weaknesses to the President and the Congress in 1983. The report cited the need for

- improved procedures to assure the quality of laboratory data submitted with pesticides registration applications and adequate internal review of the data,
- improved procedures to assure effective management of the construction grants program in states delegated responsibility for the program,
- additional procedures and guidances to assure effective state hazardous waste programs and effective enforcement of the RCRA, and
- development of more detailed procedures to strengthen the implementation of the Superfund program and to help assure consistent and effective use of Superfund resources.

In the 1984 annual report, the Administrator stated that EPA took 34 corrective actions on the four program-wide material weaknesses reported in the 1983 annual report listed above. In 1984, the Administrator again listed as a material weakness the construction grants program and added four additional areas, including the need for (1) additional procedures to continue to improve EPA's payroll system and ADP aspects of that system, (2) an ADP security plan for the maintenance of proprietary and confidential business information, (3) guidance to implement the hazardous waste requirements of the 1984 amendments to RCRA, and (4) procedures to implement the Asbestos School Hazard Abatement Act of 1984. The other three 1983 material weaknesses—laboratory pesticides data and RCRA and Superfund programs—were not reported as material weaknesses in 1984.

The Extent of Material Weakness Areas at EPA Is Substantial

The material internal control weaknesses EPA reported in 1984, taken as a whole, involve programs which encompassed over 60 percent of EPA's fiscal year 1985 budget.

For example, EPA received nearly 56 percent, or $2.4 billion, of its fiscal year 1985 funding for the construction grants program, which was acknowledged by EPA as a material weakness area. The construction

grants program, which was substantially expanded by the Water Pollution Control Act Amendments of 1956 as amended to curb the widespread pollution of the nations' waterways, was acknowledged again in 1984 as a material weakness. The program, which is expected to obligate about $45 billion from 1972 through 1985, assists municipalities to construct wastewater treatment plants. In his 1984 report, the Administrator said that this program will continue to be a material weakness due to the extent of program delegation, its highly decentralized management, and the amount of public funds involved.

On EPA's payroll system, the Administrator reported the need to process correct, complete, timely, and valid EPA payroll transactions. Improvements in input controls, segregation of duties, computer access controls, ADP software programs controls, distribution of output, and payroll documentation requirements were cited as being needed. As a result, an independent study of the payroll system by an accounting firm was determined to be necessary.

In ADP, EPA identified as a material weakness the area of security over proprietary and confidential business information in the pesticides and toxic substances area. EPA gathers and analyzes proprietary information from manufacturers of pesticides and other potentially toxic substances to determine the health and environmental risks associated with the use of these substances. In addition, EPA maintains confidential records pertaining to numerous enforcement cases which could adversely affect both the government's interests as well as those of the regulated community if not handled in a secure manner. This area involves numerous manufacturers throughout the country.

Amendments to RCRA went into effect in November 1984 and are listed in the 1984 report as a material weakness that would have a significant impact on EPA activities. The amendments outline changes in such RCRA areas as issuing permits to operate hazardous waste sites, enforcement, compliance, and responsibilities of state programs. These amendments greatly increase EPA's regulatory activity; almost 70 regulations must be promulgated. Approximately 100,000 small quantity generators of hazardous waste will soon be subject to federal controls, as well as approximately 2 million underground storage tanks, which contain petroleum products and hazardous substances. The Administrator, in the 1984 report, also said that the statutory language of the amendments is vague and that RCRA permits will not be written until EPA is able to issue interpretative guidance and regulations.

Beginning in 1976, RCRA required the establishment of a federal regulatory program controlling the management of hazardous waste. Among other things, RCRA required within 18 months of enactment, that states provide an inventory of hazardous waste sites to EPA. EPA was required to develop the inventory for states that did not submit their inventory to EPA. RCRA also required within the 18 month period that EPA issue criteria for identifying and listing hazardous waste; issue standards for handlers of hazardous waste and owners and operators of hazardous waste facilities; and issue regulations governing permits for hazardous waste treatment, storage, and disposal facilities. EPA is required to monitor and enforce compliance with the requirements of RCRA. Initially, EPA estimated a volume of about 260 million metric tons of waste being generated annually. EPA received $187 million for RCRA activities in fiscal year 1985.

Also listed as a material weakness in the 1984 report is EPA's asbestos school hazard abatement program. Its purpose is to make funds available for loans and grants to school districts for the abatement of asbestos in schools. EPA acknowledged it has no assurance that program funds are used properly and that local programs are effective and well managed. EPA expects that over 2,400 asbestos-in-school inspections will be performed in fiscal year 1985. This program has great significance to the health risks from asbestos in our nation's schools. EPA received $50 million in fiscal year 1984 to use to implement requirements of this program.

EPA's Annual Report Is Not Complete

The Administrator's 1984 annual report to the President and the Congress did not list as material two weaknesses—Superfund and RCRA programs—listed in the 1983 report that were still uncorrected as of December 31, 1984. The Administrator, in his 1984 report, said that fiscal year 1984 corrective actions have been completed in the Superfund and RCRA programs. However, we believe that the actions were not sufficient and that these two programs should continue to be listed as material weaknesses. We also believe that the 1984 report should have included various ADP operations acknowledged by EPA managers as material weaknesses because they involve a substantial part of EPA's operating activities.

As a result, EPA has not given a full picture of whether its internal control system will prevent fraud, waste, abuse, and mismanagement from occurring in its operations. Material weaknesses in these three areas are discussed below.

Superfund Program

Superfund (the Comprehensive Environmental Response, Compensation, and Liability Act of 1980) provides for cleaning up the nation's uncontrolled hazardous waste sites. The act provides for a $1.6-billion fund to be accumulated over a 5-year period from taxes on petroleum and certain chemicals and from federal appropriations. The act specifies that the parties responsible for hazardous conditions at sites should either clean them up or reimburse the government for cleaning them up.

EPA's 1984 report identified 17 completed corrective actions, primarily for the cost recovery documentation component. Also, as discussed further in chapter 3, internal control reviews were undertaken (1) in the cost recovery documentation area and (2) on the decision-making process on site cleanup and waste removal activities among the different regions.

However, the Assistant Administrator for Solid Waste and Emergency Response—the official primarily responsible for the Superfund program—reported in his November 1984 annual report on internal controls to the Assistant Administrator for Administration and Resources Management that within the Superfund program the following areas included material weaknesses that were not fully corrected in 1984.

- Identification and ranking of hazardous waste sites.
- Remedial investigations.
- Ongoing cleanup activities.
- Cost control and cost recovery documentation.
- Enforcement actions.

A recent GAO report[1] summarizes GAO's work on the Superfund program over the last several years and documents various problem areas that remain uncorrected. These areas include (1) identification, investigation and ranking of hazardous waste sites, (2) cleanup activities and the extent of cleanup required, and (3) classifying and inventorying hazardous waste sites. EPA received $620 million for Superfund activities in fiscal year 1985.

We believe the uncorrected weaknesses cited above warrant the Superfund program to have been again classified as a material weakness in the Administrator's 1984 annual report.

[1]Cleaning Up Hazardous Wastes: An Overview of Superfund Reauthorization Issues (GAO/RCED-85-69, Mar. 29, 1985).

RCRA Program

As stated earlier, EPA's Administrator reported the RCRA program as a material weakness in 1983. The RCRA program requires various program elements which remain areas in need of improvement, including the need for

- guidance for the operation of treatment, storage, and disposal facilities and
- enforcement requirements for violations of RCRA.

The Administrator said in his 1983 annual report that an internal control review would be performed on RCRA. The ICR was scheduled to be completed by September 30, 1984. To do the ICR, EPA established a task force in 1983 to (1) define the elements of quality state RCRA programs and (2) determine the role EPA should play to assure state compliance with RCRA requirements. He acknowledged that full implementation of the RCRA program will not occur for several years. (The ICR is discussed in ch. 3.)

The Administrator did not report the RCRA program as a material weakness in his 1984 annual report, although final guidance on the RCRA program was not developed and the ICR was not completed. The 1984 report outlined four corrective actions in the RCRA area and listed only the 1984 amendments to RCRA as a material weakness. (These amendments were discussed earlier on p. 16.)

We believe the RCRA program area should continue to be reported as an overall material weakness area until key requirements of the act and amendments have been met. The Assistant Administrator for Solid Waste and Emergency Response, in his November 1984 report to the Assistant Administrator for Administration and Resources Management, said that establishing a quality RCRA program was yet to be done and that additional corrective actions were needed. EPA received $187 million in fiscal year 1985 for RCRA activities.

ADP Activities

The ADP area has also not been adequately identified in the 1984 annual report as a material weakness. Also, it was not reported as a material weakness area in 1983. Nearly all of EPA's activities are supported by ADP operations, including payroll, air quality monitoring, water programs, and hazardous waste activities. EPA has 51 major ADP systems and up to 2,000 subsystems that are operated in support of EPA program activities.

EPA managers at the regional and headquarters operating levels have periodically reported ADP weaknesses in these activities. These weaknesses were outlined in the regional administrators' annual reports on internal controls to the Assistant Administrator for Administration and Resources Management, as well as in private contractor and other EPA studies.

For example, the Toxic Substances Control Act and Federal Insecticide, Fungicide, and Rodenticide Act enforcement systems contain information on compliance rates and enforcement activities associated with facilities that produce and distribute pesticides and toxic chemicals. According to the Region VII Administrator, the system currently does not produce reliable data and the region cannot use the system because of its present design.

Another ADP weakness area identified by six EPA regions and not listed in EPA's 1984 annual report is the hazardous waste data management ADP system. It provides data to the regions and headquarters on hazardous waste activities. This system contains data on regulated facilities which generate, treat, store, and transport hazardous waste material and generates data for EPA program activities. For example, Regions I and VII are no longer using the system and reported to EPA headquarters staff that (1) the system is designed primarily for headquarters use and (2) the system does not produce reliable and useful data. Both regions had to develop a separate manual system to enable them to comply with their hazardous waste responsibilities.

In addition, the Office of Solid Waste and Emergency Response, the main user of the hazardous waste data management system, stated in a 1984 letter to the Office of Information and Resource Management that there is great concern that the system is not meeting current needs. Complaints have been received from EPA headquarters and regional officials and from state organizations, including inconsistent and incomplete data, the lack of computer programs to develop appropriate output reports, and the existing system's limited capacity to sort the volume of data required.

Overall, although EPA managers identified numerous weaknesses in ADP systems, only the area of ADP security over proprietary and confidential business information in the pesticides and toxic substances area and ADP aspects related to the payroll system were reported to the President and the Congress in the 1984 report as material weaknesses. We believe,

however, that other ADP activities should also have been reported as material weaknesses.

Effectiveness of EPA's FMFIA Process Was Limited

As discussed in chapter 3, we found various deficiencies in EPA's performance under FMFIA which raise questions concerning the appropriateness of EPA's 1984 annual report.

We found that EPA did not organizationally and functionally establish the FMFIA process throughout the agency. The current organization involving a three-member headquarters project team currently lacks adequate program and operating level input at the program manager level. For example, regional program activity in the construction grants area was not segmented properly and adequately assessed for vulnerability, including about $2 billion in construction grant activity at the three regions we reviewed.

In addition, some identified medium and highly vulnerable areas, including $807 million for Superfund operations and RCRA program activities were not scheduled for ICRs. Also, verification of the adequacy of 30 percent of the completed corrective actions we reviewed was lacking, and the system established to track these actions was incomplete.

As stated earlier, OMB guidance provides that proper segmenting, assessing the vulnerability of agency program activities, performing ICRs, and completing effective corrective actions, when considered together, are to provide a basis for the end-of-year annual report.

Furthermore, EPA's OIG in evaluating the 1984 process, also reported on deficiencies in EPA's performance under FMFIA. In its final report to the Administrator in August 1985, the OIG stated that the deficiencies identified during its evaluations process "... weakened the assurance the Administrator gave to the President and the Congress on December 31, 1984, concerning the adequacy of the Agency's internal controls."

EPA Does Not Have an Adequate Basis for Providing Reasonable Assurance on Its Accounting System

As discussed in chapter 4, our review disclosed that the Administrator did not have an adequate basis to report that the Agency's accounting system is in conformance with the Comptroller General's requirements. We found that EPA had not conducted sufficient analysis and testing to make this determination.

Specifically, EPA did not (1) develop a formal plan, including policies and procedures, to implement section 4, (2) test its accounting system in operation for conformance, (3) report a material accounting system weakness concerning letter-of-credit advances we advised EPA of, and (4) sufficiently address important principles and standards in evaluating accounting system compliance. GAO believes the degree to which the condition of an agency's accounting system complies with the Comptroller General's principles, standards, and related requirements affects the internal control process.

Conclusions

EPA's 1983 and 1984 annual reports to the President and the Congress stated that its internal controls provided reasonable assurance that it was protected against fraud, waste, abuse, and mismanagement, even though material weaknesses were identified in a substantial part of EPA's activities and included in the reports. In addition, material weaknesses identified in 1983 and 1984 were not included in the 1984 report, even though they were not substantially corrected. Also, as covered in chapter 4, the Administrator did not have an adequate basis for providing reasonable assurance on EPA's accounting system. The above problems, together with deficiencies in the FMFIA process discussed in the next chapter, suggest that the Administrator did not have sufficient basis for providing reasonable assurance that EPA's internal controls are meeting FMFIA objectives.

Recommendation to the Administrator, EPA

We recommend that in future FMFIA annual reports, the EPA Administrator list all EPA internal control material weaknesses until they have been substantially corrected.

Agency Comments

EPA did not agree with our conclusions and the substance of our recommendation. EPA indicated that in accordance with OMB and GAO guidance, it reported accurately and had an adequate basis for providing assurances on the adequacy of EPA's internal control systems. We recognize that management judgment is involved in reaching a conclusion that the

internal control systems, taken as a whole, provide reasonable assurance that the act's requirements have been met. In deciding whether their systems provide reasonable assurance, we believe agencies need to consider four factors collectively:

- the comprehensiveness and quality of the evaluation work performed,
- the significance of the weaknesses disclosed,
- the status of corrective actions, and
- the extent to which accounting systems conform to the Comptroller General's requirements.

In our opinion, unless the agency's key accounting systems and internal controls over major programs and functions are adequately evaluated and tested, and until the material weaknesses which significantly impair internal controls over important agency functions are substantially corrected, the agency head does not have an adequate basis to conclude that reasonable assurance exists under the act. Evaluations and corrective actions needed to address the act's requirements may take several years to complete. An agency may be making good progress toward that goal, yet not have progressed to the point where reasonable assurance can be provided.

In EPA's case, we show in chapters 2, 3, and 4 of this report that EPA's systems have not been adequately evaluated. We also demonstrate that uncorrected material weaknesses have not been reported by EPA and will require long-term action to alleviate, and in the meantime they significantly impair internal controls over important EPA missions. Under these circumstances, we cannot agree that EPA had an adequate basis at the time of its 1984 annual report to conclude that its internal control systems, taken as a whole, fully comply with the act's requirements.

We recognize that EPA reached its judgment in accordance with guidelines disseminated by OMB. In our report on first-year implementation of FMFIA (GAO/OCG-84-3), we recommended that OMB clarify and revise its guidance on what should be contained in the annual report. The House Committee on Government Operations, in its August 2, 1984, report on first-year implementation of the act, also recommended that OMB revise its guidance concerning annual reporting. The Committee suggested that it would be more practical for some agencies to report that they ". . . have reasonable assurance except . . . ." and identify areas where they do not have assurance. However, OMB took no action on these recommendations. This issue will be discussed further in our overall report on second-year implementation of the act which is to be issued later this year.

Regarding reporting of material weaknesses, EPA did not include Superfund and RCRA weaknesses in its 1984 report that it included in its 1983 report. EPA said that even though the Superfund and RCRA weaknesses we mentioned in our draft report were not completed in 1984 and not included in the letter to the President and the Congress, they were reported and tracked in 1984 in the agency's internal tracking system. However, even though some progress may have been made towards correcting material weaknesses, we believe that weaknesses important enough to be reported in 1 year should be reported in subsequent years if the weaknesses in fact have not been substantially corrected.

In this respect, OMB's guidelines state that the annual report can and should be used to demonstrate that planned corrective actions have been taken and that a statement should be included in the annual report on the status of actions taken on prior years' weaknesses. Providing such information in future EPA annual reports will better disclose and inform the Congress of the status of corrective actions and the weaknesses to which they are directed. Specific comments on related issues raised by EPA are discussed in appendix II.

Chapter 3

Progress and Problems With the FMFIA Section 2 Internal Controls Evaluation Process

During 1984 EPA made progress in evaluating its internal control systems. Under ICPT's direction, additional segmenting of the Agency on a more functional basis was accomplished, and additional VAs were completed. In addition, EPA started to perform ICRs. An automated corrective action tracking system was also being developed.

While it has accomplished much, EPA has some FMFIA problems it needs to address to more effectively implement the act. For example, we found that:

- The objectives of FMFIA are not adequately carried out in EPA. Additional involvement of program managers in segmenting and performing VAs is needed, particularly in EPA's regional offices.
- ICRs have not been scheduled for some areas rated by EPA as having high or medium susceptibility to fraud, waste, and abuse.
- EPA's system for tracking recommended actions to correct control weaknesses omits some weaknesses and does not verify that actions shown as completed have actually corrected the control weakness.
- Staff has been insufficiently trained.
- The Office of Inspector General, with its experience and expertise in internal control matters, has had only limited involvement in EPA's FMFIA process.

Additional Segmenting Needed

The functional basis on which EPA was segmented in 1984 is an improvement over the 1982 segmenting process, which was done solely on an organizational basis. However, the 1984 segmenting process, which was based on EPA budgetary program categories, excluded various regional programs and functions. Also, some segments covered functional activities that were too broad or all encompassing to facilitate further review and analysis.

EPA guidance states that an essential step in performing a systematic evaluation of internal control systems is to divide (segment) each organization into manageable sections (or assessable units), which cover all programs and administrative functions, and that each assessable unit should be of an appropriate scope and size to facilitate the conduct of a meaningful VA.

In 1982 EPA segmented its organizations into 29 assessable units—19 headquarters and 10 regional components. During 1984, the internal control project team, in conjunction with headquarters internal control

coordinators (ICCs), reviewed the various budget categories and prepared a list of assessable units and segmented the Agency into 95 assessable units based on programs and functions, 33 of which involved some regional operations.

After the ICPT developed the agency-wide inventory of assessable units, it was distributed in April 1984 to the primary organization heads (POHs)[1] for review. The POHs were asked to identify which of the assessable units on the ICPT list had regional implications. As a result, the ICPT expanded the number of assessable units with regional implications from 33 to 35. Later an additional assessable unit was added for a total inventory of 96 assessable units.

An example of a major program area not adequately considered in the segmenting phase and subsequent VA was EPA's water office construction grants program. This program awards contracts and grants to nonfederal entities for wastewater treatment projects designed to protect and enhance environmental water quality and is EPA's major program activity in which the regions are involved. However, no regional segments were established. The construction grants program was segmented and assessed for vulnerability from a headquarters standpoint. At the three regions we reviewed, over $2 billion in budgeted funds for fiscal year 1984 was not segmented on a regional basis.

Another program area not adequately considered in the segmentation process was EPA laboratories. EPA has 27 research and development laboratories located throughout the country, none of which were designated as separate segments (assessable units). These laboratories provide analytical and technical support to the various EPA media programs, such as air, water, and waste management, and represent many distinct functional activities amenable to separate segmentation and assessment. However, EPA laboratory operations were not separately segmented and assessed for vulnerability. (See p. 29 for further information on why this area was not properly segmented.)

We also identified two special programs operated at the regional level, the Chesapeake Bay Program in Region III and the Great Lakes Program in Region V, which were not segmented into separate assessable units.

[1]The primary organization heads, or POHs, are the Deputy Administrator, assistant administrators, regional administrators, the Inspector General, and the General Counsel. They are assigned direct responsibility for evaluating, reporting on internal controls, and taking prompt actions to correct weaknesses.

The Great Lakes Program was cited in Region V's 1983 report on internal controls as a program with high vulnerability to fraud, waste, abuse, and mismanagement independent of the assessment process based on regional management's knowledge of the program. Because it was not separately segmented, EPA did not perform a vulnerability assessment of the program and has no plans to do an ICR. An ICR on the Chesapeake Bay program was not completed at the time of our review.

Programs delegated by EPA to the states for operations such as grants programs in the air, hazardous waste, and water program areas were also not separately segmented. EPA maintains an oversight and audit role over these activities. At Region IX, for example, for fiscal year 1984, these programs constituted $442 million of Region IX's total budget of $461 million. Officials at Region IX agreed that these activities should have been separately evaluated in the assessment process.

We also found that various EPA assessable units encompassed functional activities that were too broad to allow for meaningful assessments. For example, ADP activities, comprising 51 major systems with up to 2,000 subsystems were covered almost entirely by part of one segment (assessable unit). Although most of EPA's operating activities use data accumulated by EPA's ADP systems and subsystems, to date none of EPA's ADP systems have been segmented for assessment purposes.

Improving Vulnerability Assessments

EPA's ICPT at headquarters developed the initial drafts of all 1984 VAs including what the ICPT considered the necessary documentation needed in support of the evaluation process. The guidance that the ICPT developed for the VA phase was generally consistent with the OMB guidance. However, EPA did not fully involve program managers in the VA process.

The program managers' role, both at headquarters and in the regions, was primarily to review assessments done by a three member team—the ICPT—at the headquarters level. As a result, program managers with the most knowledge of ongoing EPA operations had only a limited involvement in the process.

Also, we found that VAs, for the most part, were not done at the levels at which EPA programs are operating—in regional and field locations—although some regional and field input to the process was solicited. The assessments were general in their analysis and were headquarters oriented. Overall, of the 96 VAs, only 35 had some field input, even though almost all of EPA's operations are conducted in the field.

We randomly selected and reviewed 20 completed VAs. All VAs included basic program and budget data, as well as completed analyses of inherent risk[2] and of the general control environment.[3] Some documentation (explanation) on the preliminary evaluation of safeguards and compliance with GAO standards was also included. However, overall, the assessments provided virtually no information that allowed us to determine precisely how EPA performed them or the appropriateness of the ratings given.

None of the 20 VAs we reviewed delineated all event cycles, control objectives, and control techniques for the particular assessable unit, as required by EPA guidance. Only four VAs included control objectives, and only six VAs included any mention of control techniques.

In the research and development area, except for program and budget data, 15 assessable units dealing with different media (such as air, water, hazardous waste, and toxic substances) and different EPA organizational units had identical VAs. The ICPT applied the results from one VA in this area to the remaining 14 VAs without separately assessing them for vulnerability which resulted in all 15 VAs being identical. We believe separate VAs should have been performed because each of these assessable units involved various functions from different organizations and programs. Testing water quality and toxic substances are totally different functions being carried out at organizational locations apart from the headquarters level where they were assessed.

As mentioned earlier, ADP activities are a substantial part of overall EPA operations; EPA currently has approximately 51 major systems in its operations. In its assessment of the ADP area, the ICPT used only one assessable unit at the headquarters level, the information systems and services assessable unit, even though ADP operations involve numerous headquarters and regional locations. The ICPT did not develop regional ADP segments nor assess regional ADP operations for vulnerability.

[2]The analysis of inherent risk is an assessment of the inherent potential for waste, loss, unauthorized use, or misappropriation due to the nature of the program activity. Matters considered include the program's (1) purpose, (2) budget level, (3) prior reviews, and (4) age and life expectancy.

[3]The analysis of the general control environment consists in the assessment of the overall environment in which the program activities are conducted. Factors considered include (1) policies and procedures, (2) management attitude, (3) personnel, and (4) ADP considerations.

EPA's VA process only generally touched on ADP internal controls[4] ; no individual ADP system or subsystem was assessed. In doing the VA on the information systems and services assessable unit—which was to have covered the ADP area—EPA listed 16 general management event cycles for consideration. The event cycles identified were broad in their scope. They included management, procurement and operations issues, as well as telecommunications issues. As stated in chapter 2, the regional offices informed EPA headquarters of numerous problems experienced in performing functions supported by ADP activities.

In each of EPA's other 95 VAs, an analysis was made of the general control environment. One factor in the analysis was "ADP considerations," which could be evaluated as either "satisfactory" or as "other." No other analysis of ADP was required. Based on the information systems and services VA, EPA rated its ADP activities as highly vulnerable but no adequate corrective action plans were developed for the ADP area.

In the construction grants program, we noted similar vulnerability assessment problems. The ICPT completed one VA entitled "municipal source control" at the Washington headquarters level without assessing regional operations for vulnerability. At the three regional offices we visited, vulnerability assessments were not done on over $2 billion of operations. The VA we reviewed on the construction grants program includes functions such as (1) grant awards for about 650 projects annually—EPA had over 4,711 active projects at the end of fiscal year 1984—and (2) projects management, performed by the EPA regions and the U.S. Army Corps of Engineers.

Improving Internal Control Reviews

EPA did not perform ICRs in 1983 but has made progress in developing guidance for performing them. In 1984 we reviewed all seven agency-wide[5] ICRs and the one ICR that was completed in Region V. Region III had not completed an ICR at the time of our visit. ICRs were not done in Region IX. For four of the eight ICRs we reviewed, EPA did not review the effectiveness of internal controls or do testing of the internal controls.

[4]ADP internal controls can be divided into two major categories: general controls and application controls. General controls are those that apply to the overall management of the ADP function in an agency. For example, some general controls included the plan of organization and operation of the ADP activity. Application controls are those controls related to specific computer applications. Application controls often are categorized as data origination, input, processing, and output controls.

[5]Agency-wide ICRs are those that involve analytic activity throughout EPA while regional ICRs involve analysis at a specific location of specific functions.

Also, the ICPT did not complete quality assurance and some areas receiving high and medium vulnerability ratings were not scheduled for ICRs.

Guidance Requires an ICR or Alternative Actions to Be Performed

In its December 1982 guidelines, OMB described an ICR as a detailed examination of an agency's internal controls to determine whether sufficient control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost-effective manner. OMB further states that, in the event the VA phase identifies program activity areas as having either high or medium vulnerability to fraud, waste, abuse, and mismanagement, they are to be the subject areas for ICRs. Agencies have the option of choosing alternatives to ICRs, such as scheduling Inspector General audits of the area or taking corrective action immediately.

As noted in chapter 1, OMB recommends a phased approach for performing ICRs: (1) identifying event cycles, (2) analyzing the general control environment, (3) documenting event cycles, (4) testing internal controls, (5) evaluating internal controls within the event cycle, and (6) reporting the results. OMB specifies that in reviewing the event cycles contained within internal controls, the evaluation should

- determine whether sufficient internal control objectives have been established and control techniques are functioning as intended,
- identify apparent weaknesses in either the design or functioning of the internal control system,
- recommend necessary corrective actions, and
- establish a formal followup system for management consideration so that appropriate corrective actions are taken promptly.

EPA Order 1000.24 reiterates the requirements contained in the OMB guidelines. EPA issued ICR procedures in October 1983. It also issued revised guidance on performing ICRs in March and June 1984. The March guidance requires program managers to approve alternatives to ICRs before completing other forms of corrective actions. Managers could cancel, suspend, or delay ICRs but had to explain the reasons for their decisions in writing to EPA's Assistant Administrator for Administration and Resources Management. The June 1984 procedures included requirements for quality assurance procedures to be performed by the ICPT.

Some ICRs Did Not Include Adequate Testing and Identification of Event Cycles

In 1984, EPA headquarters scheduled ICRs in seven program-wide areas: (1) Superfund cost recovery, (2) regional consistency in hazardous waste site cleanup activity, (3) RCRA, (4) water programs, (5) procurement, (6) environmental impact statement preparation, and (7) financial assistance to grantees.

The EPA Administrator's 1984 annual report to the President and the Congress stated that five of seven planned agency-wide ICRs were fully completed. The report said ICRs were generally performed in accordance with EPA guidance. Our evaluation of the seven ICRs initiated at EPA headquarters, as well as one completed at Region V, showed that three of five completed agency-wide ICRs and the regional ICR we reviewed did not include sufficient analysis. Therefore, they may not be a reliable measure of whether EPA's controls are appropriate and operating as intended.

For example, an agency-wide ICR on procurement practices addressed EPA offices' compliance with EPA-established procurement and contract regulations and practices, such as (1) justifying a basis for noncompetitive procurement, (2) reporting on the reasonableness of the prices and/or costs, and (3) complying with contract terms and conditions. The review tested to determine whether program managers followed existing EPA regulations and practices. The ICR did not, however, evaluate whether existing regulations and practices, even if followed, would provide adequate internal control over EPA's procurement activities.

Another ICR, of the Superfund area, dealt with regional consistency in the decision-making process on site cleanup and waste removal activities. A major component of the ICR was a consultant's analysis of 129 hazardous waste removal decisions at the 10 EPA regions between October 1983 and May 1984. The analysis involved preparing profiles of regional actions taken according to criteria for undertaking removals—incident and site type, substances involved, nature of the threat, and type of cleanup response. Neither the consultant nor EPA determined whether controls were operating as intended. This could be accomplished by testing control techniques in place.

An ICR on EPA headquarters environmental impact statement preparation under the Clean Air Act was done generally in accordance with OMB guidance. However, all of the internal control techniques involved in statement preparation and review were not reviewed or assessed as part of the ICR process. For example, a technique dealing with the need for

revised procedures to approve impact statements was not fully evaluated.

EPA's OIG also evaluated the seven agency-wide ICRs for conformance with EPA guidance. In an October 22, 1984, letter to the Director of the ICPT, OIG identified various problems with the ICRs similar to those we noted. Problems included limitations on testing and sampling in the procurement practices and Superfund ICRs, and inadequate delineation of event cycles in the environmental impact statement ICR.

Region V completed an ICR on the RCRA permit process. The ICR addressed one RCRA area and concentrated primarily on legal issues, such as conducting public hearings, maintaining evidence, and writing regulations to enforce permits. However, the review did not test the internal control techniques to determine if controls were functioning as intended. The only documentation available to support the ICR consisted of records of meetings.

Quality Assurance Not Performed

Although OMB recommends that each agency have quality control to assure that ICRs are performed in a quality manner, the ICPT did not perform quality assurance steps on the ICRs completed in 1984. The ICPT outlined the methodology it would use for quality assurance of ICRs and said agency-wide ICRs would be examined each year while others would be selectively examined. The methodology was sent to headquarters and regional internal control coordinators in July 1984. The ICPT said it may review any of the various ICR components, including event cycles, control objectives, control techniques, testing of techniques, reporting of results, and documentation. The methodology was to include reviewing such things as

- the control objectives of those event cycles under evaluation to determine whether the objectives appear to be complete, logical, and applicable;
- the sampling approach to determine if sufficient testing of control techniques was done;
- the reasonableness of reported results, including the action plan describing corrective actions taken or planned, including whether milestones are available; and
- the adequacy of documentation to determine whether it is sufficient for program managers to conclude whether the type and extent of testing performed was sufficient and whether the conclusions reached on the basis of the tests were sound and logical.

The ICPT planned to provide feedback to managers responsible for performing the ICRs and to use the ICR results to make necessary changes to guidance provided to the performing offices.

The ICPT Director cited a lack of staff resources as the reason quality assurance steps could not be done. While we recognize EPA's resource constraints, performing quality ICRs is a critical component of the FMFIA process.

Limited ICRs Have Been Scheduled

OMB guidance states that assessable units receiving a high or medium rating in the vulnerability assessment process are to be the subject of an internal control review or alternative corrective action during the next annual evaluation cycle. In the 1984 process, EPA tentatively identified 10 high and 21 medium vulnerable areas. However, in fiscal year 1985 as discussed in the Administrator's 1984 annual report, EPA scheduled only one ICR—construction grants. Although EPA planned alternative actions in each area, we believe EPA should also schedule and perform more ICRs.

There have been alternative corrective actions to ICRs in the Superfund and RCRA areas, including (1) GAO and OIG audits, (2) increased monitoring procedures, (3) more training for program personnel, (4) revised guidance and instructions, and (5) modified procedures or documents.

However, RCRA and Superfund are examples of programs which could still benefit from ICRs. EPA did not complete ICRs on RCRA and Superfund programs, although these ICRs were initially scheduled to be completed by September 30, 1984. The Administrator's 1983 annual report had described both programs as having material weaknesses. The Administrator's 1984 annual report also acknowledges that ICRs were not completed and characterized the earlier work done as progress reports. Yet, no ICR is scheduled for either area in fiscal year 1985.

In the area of ADP, while various EPA managers have identified numerous areas as highly vulnerable, EPA did not schedule ICRs for 1985. The Director, Office of Management Planning and Evaluation, said ICRs were not scheduled because the weaknesses identified in the vulnerability assessment process may be corrected with alternative approaches such as audits. We believe that additional ICRs should be scheduled because of the substantial impacts ADP has on EPA activities.

Improving the Corrective Action Tracking System

Accomplishing FMFIA goals requires appropriate and timely corrective actions to be taken on weaknesses identified in the systems reviewed. During the 1983-84 period, EPA identified about 727 internal control weaknesses—552 in 1983 and about 175 in 1984. The Administrator's 1984 annual report said EPA took corrective action on 525 of these weaknesses. In 1984, EPA initiated an automated corrective action tracking system to track the status of reported weaknesses and corrective actions taken.

However, EPA's tracking system does not track all identified internal control weaknesses. In addition, EPA's system does not provide for testing or evaluating the results of reported corrective actions to ensure that effective corrections have in fact taken place. Without these components, EPA top management may not have a good basis for determining the progress EPA is making in correcting internal control weaknesses—a primary objective of FMFIA.

EPA's Corrective Action Tracking and Followup System Is Not Complete

EPA's corrective action tracking and followup system did not track all recommendations for corrective actions from FMFIA or other sources during the 1983-84 period. OMB guidelines state that completing VAs and ICRs is not an end in itself, but that determining, scheduling, and taking the necessary corrective actions as promptly and timely as possible is critical.

OMB's guidelines provide that agencies establish a formal followup system for corrective actions that logs and tracks recommendations and target dates, provides assistance for developing plans to implement corrections, and monitors whether the changes are made as scheduled.

Based on solicitation of the primary organization heads, EPA identified about 727 internal control weaknesses—552 in 1983 and about 175 in 1984. However, EPA's first tracking system report, made available to us in November 1984, included information on only 280 of the 552 internal control weaknesses identified in 1983. The Director, ICPT, told us he was unaware that the system was incomplete but added that the system would eventually include all of the weaknesses identified.

In April 1985, the ICPT Director gave us a report reflecting the status of reported weaknesses as of September 30, 1984. That report included information on 481 of the 552 weaknesses.

Subsequent status reports dropped weaknesses reported as corrected by ICCs and program managers. As discussed in the next section, these weaknesses are being deleted from the system before the ICPT has tested or verified that they have in fact been adequately corrected. For example, the first quarter report for fiscal year 1985 included only 90 of the 552 weaknesses identified in 1983. According to the Director, ICPT, the remaining 462 weaknesses had been reported, corrected, and were no longer being tracked by the system.

Of the approximately 175 weaknesses identified in the POHs' 1984 annual reports on internal controls, only 75 were included in the first quarter fiscal year 1985 report. Similarly, as with the 1983 weaknesses, 1984 weaknesses were dropped because the ICCs and program managers reported corrective actions as completed.

EPA's headquarters corrective action tracking system contained only weaknesses identified in the 1983 process and those identified in the 1984 annual reports from POHs on internal controls. Recommendations based on completed ICRs were not tracked in the system. For example, the construction grants ICR contained about 40 major recommendations, with additional sub-recommendations. The ICR on financial assistance contained 72 recommendations, while the ICR on regional consistency in the hazardous waste removal system had 15 recommendations. The ICR on environmental impact statement preparation and review under the Clean Air Act had five. None of the identified weaknesses and corresponding recommended corrective actions were included in the tracking system.

Testing and Followup of Corrective Actions Are Needed by Program Managers

EPA managers did not accurately report the status of all corrective actions taken, nor did they provide for testing and followup to determine whether the reported actions taken have corrected the problems. Without followup and testing, management does not have adequate assurances that internal control problems are being resolved.

Although EPA provided us a summary of each weakness reported in 1983, it was unable to furnish us with a report which provided the status of each corrective action—whether the action was taken, in process, or planned. Nevertheless, in its 1984 annual FMFIA report, EPA reported to the President and the Congress that it had corrected approximately 450 of the 552 weaknesses. The Deputy Assistant Administrator for Administration and Resources Management also reported a similar

accomplishment in a letter dated September 4, 1984, to the Chairman of the House Committee on Government Operations.

To determine the validity of EPA's completed corrective actions, we randomly sampled 25 of the 552 internal control weaknesses at six headquarters offices and at the three regional offices where we performed our review. Regional and headquarters officials acknowledged that corrective actions on 5 of the 25 weaknesses were not complete at the time of our evaluations. Our testing of the remaining 20 weaknesses reported as complete showed that in six cases, EPA could not substantiate to us the weaknesses had been corrected.

For example, EPA's headquarters Office of Solid Waste and Emergency Response reported that it had failed to always charge travel expenses to the appropriate hazardous waste site accounts and that this hindered cost recovery under the Superfund program because these expenses were not supportable. Although new guidance was issued and training scheduled, Office of Solid Waste and Emergency Response officials have not determined that the information necessary to support cost recovery of Superfund expenses, including travel, is being properly charged.

Region III reported that reviews were not being done to assure that records disposal actions taken were in compliance with records control schedules. The Regional Administrator's 1984 annual report on internal controls reported this weakness had been corrected by (1) assigning responsibility of records management to the regional librarian and (2) appointing divisional coordinators to review records control functions. However, the responsible corrective action official told us that, in his opinion, although there was progress, the problem remained uncorrected. He could not document that the librarian was assigned record management responsibility and could not explain why the annual report stated that the weakness had been corrected.

In another example, Region V reported as completed, corrective action on the need for U.S. government support and involvement in international water quality activities. However, the staff chief of the Great Lakes National Program Office told us EPA did not take any corrective actions because of a lack of resources.

Based on an OIG audit disclosing timekeeping irregularities, Region V reported that it had no policy on timecard controls. The region (1) issued guidance, (2) established written requirements, and (3) initiated timekeeper training and then reported the weakness as corrected. However,

the region performed no testing or followup evaluations and had no assurance the techniques established were being implemented and that timekeeping irregularities were reduced.

The region also reported that contracting procedures and procedures to process and review construction change orders were not consistent with EPA regulations and guidelines. Although the region reported that corrective actions on these weaknesses were completed, a municipal facilities branch chief told us that no formal corrective action had been taken to resolve the issue. Regional officials said they would monitor this area and that they may in the future conduct a followup review to determine whether the problem had been resolved.

Region V also reported as a weakness that states may not be adequately accounting for supply purchases of $10,000 or less, under the Superfund program. Based on review of state records and informal discussions with state officials, the region concluded there was no significant problem with existing procedures. No subsequent analyses or tests were performed, and EPA reported the weakness corrected.

Region IX reported that inadequate financial controls existed over level-of-effort contracts, causing time and cost overruns. The region reviewed its operation and recommended (1) project officer training, (2) reviews of EPA policies on contracting, and (3) greater flexibility for the region to solicit level-of-effort contractors when special needs arise. The region reported the weaknesses corrected, although it had not trained its project officers or determined that controls were actually improved.

Need to Fully Define Roles in the FMFIA Process

FMFIA is intended to be a permanent self-assessment process involving program managers at the various levels of responsibility. In accordance with OMB guidance, the process should be systemically established and include functions for all responsible program managers, so that the FMFIA process might benefit from their background and expertise.

EPA's current FMFIA role has been vested by the Assistant Administrator for Administration and Resources Management (formerly the Assistant Administrator for Administration) in the ICPT at the headquarters level. However, there is no implementing order or other memorandum detailing the ICPT's functions, duties, and responsibilities. EPA used the project team approach because of many management changes in the agency resulting from the 1983 resignation of the Administrator, as well as other top-level officials.

Essentially, the current FMFIA process is centrally controlled by the ICPT; the regional role is generally reactive in nature. Duties and functions have not been prescribed in any detail, regarding team members or headquarters and regional EPA officials.

At the three regions we visited, regional managers told us that they have little or no responsibility for compiling the inventory of regional programs and functions; assessing the vulnerability of programs and functions for weaknesses; and planning subsequent courses of action, such as ICRs. For example, Region III issued no written directives delineating FMFIA duties within the region nor a formal memorandum explaining how to implement the act. The responsible Assistant Regional Administrator provides little FMFIA program oversight, and the program had little continuity. Since the inception of the program, there have been four regional ICCs. Also, regional division chiefs—the day-to-day managers of regional programs—were not officially assigned an FMFIA role.

We believe EPA needs to permanently establish, both organizationally and functionally, the FMFIA process beyond the current ICPT approach. The process as implemented lacks adequate individual program and operating level self-assessment, a key ingredient in the FMFIA process. Also, departure of the ICPT members from an FMFIA role can cause a critical loss of program continuity and expertise. The ultimate responsibility for good internal controls rests with management. Evaluating and correcting control weaknesses should not be a separate, specialized process, but an integral part of a manager's responsibilities.

Need to Expand Training Efforts

We found that EPA provided limited training to program managers involved in the FMFIA process. EPA training efforts have consisted of discussions of FMFIA requirements at periodic meetings. The ICPT met with selected managers and ICCs to describe the process to be accomplished.

OMB guidelines specify that agencies should provide training and orientation sessions to explain the objectives of and procedures for conducting the FMFIA process and completing VAs and ICRs. In the EPA February 1984 order, the Assistant Administrator for Administration and Resources Management was directed to provide guidance and training on performing VAs, ICRs, and procedures for conducting other FMFIA activities. The ICPT Director confirmed, however, that EPA has provided little formal training on the internal control process. He added that various informal sessions and briefings have been held and guidance materials issued.

Concerning FMFIA training in the regions, we found that:

- At Region III the current ICC, appointed in September 1984, informed us as of the end of February 1985, at the time of our visit, that he had not received formal training in the FMFIA process and is unfamiliar with his responsibilities. As noted earlier, since inception of the program, the region has had four ICCs. Only the first ICC received training consisting of a 1-day session at headquarters which he told us was "less than comprehensive." None of the Region III division chiefs or program managers were trained in FMFIA requirements.
- At Region V, managers and ICCs informed us that there was no formal training in 1983 and that two staff members attended training sessions in 1984. Also, the ICPT and the regional ICC provided briefings on VAs and the overall evaluation process. Regional officials said these sessions were provided to enable the region to complete certain steps in the process, but that the briefings did not provide the kind of information needed to enable a complete understanding and commitment to the FMFIA process. The ICPT did not discuss (1) how to accomplish tasks in different phases of the FMFIA process, (2) what the focus should be — dollars or program issues, (3) what is expected of the managers, or (4) what the agency expects to achieve through the FMFIA process.
- At Region IX, the ICC said that two or three briefings of 1 to 2 hours were held in 1984 at which FMFIA materials were distributed.

Greater Inspector General Involvement Desirable

Because of its training and internal review experience, EPA's Office of Inspector General could play a more active role in achieving FMFIA goals at EPA. In 1984, however, OIG was primarily a reviewer of completed assessments and reviews and was not actively involved in the planning or implementation phases. We believe that future FMFIA evaluations efforts would be enhanced if OIG assumed an expanded role in the process.

OMB's FMFIA guidelines recognize the potential for agency inspectors general to make a positive contribution to the evaluation of agency internal controls and accounting system evaluations. The guidelines also encourage inspectors general to provide technical assistance in strengthening internal control and accounting systems, in addition to evaluating these systems as part of their normal reviews and audits of agency functions. EPA's FMFIA order assigns responsibilities to OIG in several areas, including (1) providing technical assistance in the Agency's effort to

evaluate and improve internal controls and (2) reviewing internal control documentation and evaluations to determine compliance with EPA guidelines.

In the 1984 evaluations period, OIG did many of the things envisioned by OMB and the EPA order, but not all. OIG's role consisted primarily of comments, when requested, on certain guidance developed by the ICPT; brief analyses and comments on completed ICRs; an analysis of the propriety of a draft of EPA's 1984 FMFIA report to the President and the Congress; and an audit of EPA's 1984 FMFIA process.[6]

The ICPT did not request OIG to provide participating EPA offices with technical assistance on completing the process. Accordingly, the OIG did not participate in (1) segmenting the agency, (2) completing VAs and ICRs, (3) performing quality control procedures, or (4) following up on recommendations for corrective actions. We believe a more active role by OIG would strengthen EPA's internal controls evaluations.

Conclusions

Various areas of EPA, notably at the regional level and in the ADP area, should be further segmented so that sufficient vulnerability assessments will be made of regional activities. The VA process as completed by the ICPT did not fully use the background knowledge and expertise of experienced program managers, contrary to OMB's emphasis in FMFIA that the process should be self-assessment. We also believe EPA needs to permanently establish, both organizationally and functionally, the FMFIA process beyond the current project team approach.

Some of the ICRs done by EPA did not include sufficient analysis, although EPA made some progress in the ICR phase. Not all acknowledged medium and high vulnerability weakness areas identified in the FMFIA process have been scheduled for ICRs. Also, although EPA is making progress in developing a corrective action tracking and followup system, the system did not include all weaknesses identified in the FMFIA process or provide for systematic monitoring and followup.

The FMFIA process would also be enhanced by additional training of managers and staff who should work on evaluating controls. We also encourage EPA's FMFIA officials to work with the Inspector General to have his office become more involved with implementing the process.

[6]OIG provided the Administrator a preliminary report on Nov. 30, 1984; an updated interim report on Dec. 18, 1984; and a final report on Aug. 5, 1985.

Recommendations to the Administrator, EPA

To more effectively implement the FMFIA process and to provide a stronger basis to report on the status of EPA's internal controls, we recommend that the Administrator

- require additional segmentation and assessment of EPA programs and functions at the regional and local levels of operations, especially in the hazardous waste, construction grants, and ADP activity areas;
- fully define EPA's program managers' role in the FMFIA process, with a view toward having managers be more involved in evaluating internal controls;
- schedule ICRs for identified high and medium vulnerability weakness areas, where other forms of corrective actions were unsuccessful or inappropriate;
- have the FMFIA tracking system monitor and followup on all internal control weaknesses;
- require responsible program managers in the various EPA functional areas to validate that actions taken to correct weaknesses reported as corrected are adequate to prevent or reduce their recurrence; and
- assess FMFIA training needs and train staff as necessary.

Agency Comments

EPA agreed with our recommendation to schedule ICRs for identified high and medium vulnerability weaknesses to the extent that ICRs and related actions are appropriate. EPA pointed out, however, that options to ICRs may be appropriate in some cases. EPA also agreed with our recommendation to assess FMFIA training needs and train staff as necessary. EPA said that in fiscal year 1985, it took steps to ensure that staff were trained in the FMFIA process.

EPA agreed with our recommendations to have the FMFIA tracking system monitor and followup on all internal control weaknesses and to require responsible program managers to validate that actions taken to correct weaknesses reported as corrected are adequate. EPA said that it has taken appropriate steps to update the tracking system, as well as to require program managers in their annual reports, to indicate that the corrective actions taken are appropriate.

Although EPA agreed with our recommendation, testing and followup on the adequacy of corrective actions taken were not being done. Until all weaknesses are tracked and followed up on, our recommendation will not be completely implemented.

EPA did not agree that additional segmenting and assessment of the Agency at the regional and local levels of EPA operations was needed. EPA stated also that EPA's Order 1000.24 established the FMFIA process throughout the Agency, including the program manager roles at the regional and local levels of EPA operations.

EPA's assessment process is headquarters oriented both in the conduct of VAs and of ICRs. As an agency with decentralized operations, further segmenting and conducting VAs at the regional and local level of operations of EPA are necessary, consistent with OMB guidance.

EPA Order 1000.24 outlines the responsibilities of the Assistant Administrator for Administration and Resources Management, the OIG, General Counsel and other POHs. It does not, however, define program manager and regional and local level participation below the POHs in the FMFIA process either organizationally or functionally. Even the ICPT was never officially appointed by order or otherwise organizationally or functionally to an FMFIA role. Currently, all three of the original ICPT members no longer function in a FMFIA capacity, and the current ICPT head has no officially designated organizational capacity or FMFIA role.

Chapter 4

EPA Needs to Strengthen Its Accounting System

In his second annual FMFIA report, EPA's Administrator stated that except for three material accounting weaknesses, the Agency's accounting system, taken as a whole, conformed with the Comptroller General's principles, standards, and related requirements[1] during fiscal year 1984. Also, the Administrator reported on the Agency's efforts to correct the accounting system weaknesses identified in the 1983 FMFIA report. In 1983, the Administrator also stated that the Agency's accounting systems[2] were in general compliance with the objectives prescribed by the Comptroller General.

Our review showed that EPA has made progress in implementing section 4 of the act. The Agency developed an inventory of its accounting subsystems and initiated action to correct the accounting system weaknesses identified in the 1983 report. Also, EPA management views the FMFIA process as having major long-term benefits. The Agency's section 4 efforts have brought to management's attention accounting system problems.

Our review, however, disclosed that the Administrator did not have an adequate basis to report that the Agency's accounting system is in conformance with the Comptroller General's requirements. We found that EPA had not conducted sufficient analysis and testing to make this determination.

Administrator Reports Accounting System Is in Conformance

EPA has one accounting system that it calls the financial management system. This automated, nationwide system serves as the Agency's accounting, fund control, and monitoring system. Overall responsibility for system operation and maintenance is centralized in EPA. Accounting information is entered into the system from 16 locations throughout the country: 14 financial management offices and the headquarters budget and payroll offices.

[1]The GAO Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies. Specifically, title 2 prescribes the overall accounting principles and standards, while titles 4, 5, 6, and 7 specify requirements governing claims; transportation; pay, leave, and allowances; and fiscal procedures, respectively. Also, agency accounting systems must include internal controls that comply with the Comptroller General's internal control standards and related requirements such as Treasury Financial Manual and OMB circulars.

[2]The payroll system was reclassified as a subsystem of the financial management system in 1984.

Section 4 of the act requires agency heads to report to the President on whether their agencies' accounting systems conform with the Comptroller General's principles, standards, and related requirements. Based on a review of the financial management system, the EPA Administrator reported that the Agency's accounting system, taken as a whole, conformed during fiscal year 1984, with the exception of the following three material accounting weaknesses:

- Contract costs had not been recorded and charged to the proper appropriation accounts.
- Grant money that remained unspent after the period of availability had not been deobligated.
- Documentation and data controls had not been established for the payroll subsystem.

To determine conformance with the Comptroller General's requirements, EPA assigned one staff member—a systems accountant in the Financial Management Division—lead responsibility for conducting the section 4 review. To determine conformance in 1983, the accountant used a checklist that covered the Comptroller General's April 18, 1983, Statement of Accounting Principles and Standards for Federal Agencies. In 1984, the accountant used a questionnaire developed by the Department of Transportation covering Title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies, which contains many of the Comptroller General's accounting principles and standards. The accountant relied primarily on his knowledge of the Agency's accounting system when completing the 1983 checklist and the 1984 questionnaire. In 1984 the accountant also requested that the headquarters branch chiefs within the Financial Management Division review his work products and identify any additional accounting system deficiencies. In its 1984 FMFIA report, EPA also stated that it reviewed recently issued OIG and GAO audit reports to identify the impact of reported accounting system deficiencies.

Two of the three accounting system weaknesses reported by the Administrator in 1984 concerning contract costs and grant money were brought to EPA's attention by us during this review. Efforts by EPA to correct these problems are discussed on pages 51-52. To correct its payroll problems, the third reported material weakness, EPA plans to implement new data entry and control procedures in the payroll subsystem and to have a private accounting firm complete an in-depth study of the payroll office.

EPA Has Made Progress in Implementing Section 4 of FMFIA

During fiscal year 1984, EPA took positive steps to implement section 4 of the act. Specifically, the Agency developed an inventory of its accounting subsystems and initiated action to correct the weaknesses it reported in 1983.

Inventory of Accounting Subsystems

A first step in meeting the objectives of section 4 of the act is identifying all accounting systems and subsystems so that they can be properly evaluated. As part of its section 4 efforts in 1984, EPA reported that it inventoried its accounting subsystems and related processes. The accountant who conducted the section 4 review told us that he determined whether all accounting operations, such as receipts and disbursements, flowed into the financial management system from the various financial management, budget, and payroll offices. Also, he told us that EPA has 16 major accounting subsystems and related processes, such as the grants information and control system and the payroll system, that enter information into or extract information from the financial management system.

Efforts to Correct the 1983 Reported Weaknesses

During fiscal year 1984, EPA initiated action to correct the three accounting system weaknesses identified in its 1983 report to the President and the Congress. Those weaknesses were (1) accounts payable were not being recorded monthly, (2) property accounting was not integrated into the general ledger control accounts, and (3) cost accounting techniques were not implemented according to the accounting system's design.

However, although EPA had reported in its 1983 FMFIA report that it planned to correct these weaknesses by September 30, 1984, the property and cost accounting weaknesses had not been corrected during our review. EPA reported in its 1984 FMFIA report that it planned to correct these two weaknesses during fiscal year 1985. At the time of our review, EPA had several actions underway to correct these weaknesses. We believe the Agency's actions, if properly implemented, should correct these two weaknesses.

To correct the property accounting weakness, EPA has developed procedures for recording property acquisitions directly into the financial management system's general ledger accounts. EPA plans to compare, on a monthly basis, data from its personal property accounting subsystem

with data recorded in the financial management system and reconcile any differences.

In an effort to correct the cost accounting weakness, EPA contracted with an accounting firm to evaluate EPA's need for more cost accounting information. Additionally, EPA sought and received GAO guidance on its plans to implement cost accounting techniques for the Superfund program and to implement other methods for identifying costs for non-Superfund programs. The accountant who conducted the section 4 review told us that EPA was working on implementing these cost accounting techniques and methods.

Section 4 Is Viewed As Having a Positive Impact

EPA management views the Agency's section 4 effort as productive and its impact as positive. According to EPA's Director, Financial Management Division, the benefits include (1) identifying accounting system weaknesses, (2) focusing management attention on accounting system weaknesses, and (3) increasing vigilance over the Agency's accounting system operations.

The Director, however, told us that some problems exist in the review process, such as the lack of in-depth testing. EPA planned to conduct in-depth testing of the financial management system, including the payroll subsystem. Additionally, the Director cited as problems the shortage of staff to conduct the section 4 review and uncertainty regarding the degree of testing required to support compliance determinations.

While we recognize that difficult trade-offs have to be made in order to resolve its section 4 staffing problem, EPA may need to temporarily adjust its staffing priorities. Once the evaluations are conducted, EPA would need only to update them as system changes arise and periodically check to assure that the system is still being properly implemented. Regarding testing, it is difficult to specify a testing methodology that could be used on a government-wide basis, given the significant variances among systems. EPA could coordinate its testing efforts with its OIG and GAO by seeking their comments on its test program.

Additional Action Is Needed Before EPA Can Report That Its Accounting System Is in Conformance

Although EPA has made progress in implementing section 4, our review showed that it had not yet conducted sufficient analysis and testing to report accounting system conformance to the Comptroller General's principles, standards, and related requirements. Specifically, EPA did not (1) develop a formal plan, including policies and procedures, to implement section 4, (2) test its accounting system for conformance, (3) report a known material accounting system weakness regarding the Agency's improper recording of letter-of-credit advances, (4) sufficiently address important principles and standards in its accounting system compliance evaluation, and (5) systematically consider OIG reports in the section 4 review process. In addition to correcting these problems, EPA should make use of the OIG's experience and expertise to strengthen its accounting system evaluation process.

Need to Develop a Formal Section 4 Plan

Although EPA issued instructions to implement section 2 of the act, it did not have a formal plan for implementing section 4. We believe that an implementation plan would help ensure that the accounting system is properly evaluated and the act's objectives are met. Such a plan should include policies and procedures on the nature, extent, and scope of the section 4 review efforts.

The EPA Director, Financial Management Division, who had been delegated responsibility for section 4 implementation, said that specific policies and procedures are not needed since EPA has assigned only one person to do the detailed work to determine whether the accounting system conforms with the Comptroller General's requirements, and that the assigned accountant keeps him informed about implementation activities.

Having a formal plan to implement section 4 can help ensure that accounting system evaluations are carried out efficiently and effectively over both the short and long term. A formal plan that includes policies and procedures on the goals, timetables, and staffing requirements should provide continuity and direction for subsequent reviews of the accounting system, which we believe most likely will require more than one staff person. The Comptroller General stated in September 1983 that agencies should, among other things, establish policies and procedures to ensure that their accounting systems are evaluated efficiently and effectively. The Comptroller General also stated that carefully developed policies are essential for agencies' short- and long-term implementation of section 4. Additionally, EPA officials have been encouraged

to establish formal policies and procedures by OMB Financial Integrity Task Force officials.

Need to Test Accounting System for Conformance

During fiscal year 1984, EPA financial management officers conducted some limited transaction testing of its accounting operations as part of an internal review program. This testing was conducted at 2 of its 14 financial management offices to determine whether selected accounting operations were being properly conducted in accordance with the Agency's policies and procedures. The testing was not designed to determine accounting system conformance with key Comptroller General principles, standards, and related requirements, such as accounting for property, advances, and unliquidated obligations. The EPA accountant who conducted the Agency's section 4 review told us that he did not test the accounting system's operations for conformance with the Comptroller General's requirements because he did not know testing was necessary to make the conformance determination.

To determine whether a financial system conforms to the principles, standards, and related requirements prescribed by the Comptroller General, it is necessary to review and test the system in operation. Although agency personnel may have extensive system knowledge, systems may operate differently than they believe. Therefore, testing should be done on critical aspects of the system and may include

- interviewing persons who operate the system,
- observing operating procedures,
- examining system documentation,
- applying procedures to live transactions and comparing results,
- direct testing of computer-based systems by use of simulated transactions, and
- reviewing error reports and evaluating error followup procedures.

Tests should be designed to disclose whether valid transactions are processed properly and whether the system rejects invalid transactions. The tests should cover the full cycle of the transaction, from initial authorization through processing, posting to the accounts, and reporting. Accordingly, manual as well as automated operations must be included. In developing test plans, the results of any prior system testing should be considered.

These testing criteria have been adopted by OMB and included in Appendix H of its publication, Guidelines for Evaluating Financial Management/Accounting Systems (May 20, 1985). In determining the tests that would be appropriate for any system, it is important to keep in mind that in most cases, using transaction testing as the key, more than one of the above techniques are needed to test all important aspects of an accounting system.

The Administrator reported in the Agency's 1984 FMFIA report that EPA will implement in-depth testing of the accounting and payroll systems during fiscal year 1985. We believe that testing, if appropriately conducted, should give EPA a basis to report on whether the accounting system operates in conformance with the Comptroller General's principles, standards, and related requirements.

GAO Testing Identified Some Material Accounting System Weaknesses

The importance of reviewing and testing the accounting system in operation is demonstrated in part by the weaknesses we found upon reviewing certain aspects of EPA's financial management system. To determine whether selected aspects of EPA's accounting system were in conformance, as well as whether selected OIG-reported accounting system weaknesses had been corrected, we (1) reviewed the process by which EPA accounts for and disburses monies on contracts and grants and (2) conducted limited transaction testing.

Our review of selected contract and grant transactions showed that EPA did not (1) properly record and charge contract costs to the correct appropriation accounts, (2) recover unspent grant funds, and (3) properly record letter-of-credit advances. While we found that EPA's operations in these three areas were not in conformance with the Comptroller General's accounting principles and standards and constituted material weaknesses, we did not determine that there were violations of 31 U.S.C. 1341, Section 3679 of the Revised Statutes (the Anti-Deficiency Act). A discussion of the methodology we used in selecting our sample and projections of our results appears in appendix I.

In October 1984, we informed EPA's Director, Financial Management Division, of our review results, and the Agency reported two of the three material accounting system weaknesses we identified in its 1984 FMFIA report. EPA has developed plans to correct these two weaknesses which, if properly implemented, should resolve them. EPA chose not to report the third weakness we identified, which involved the improper recording of letter-of-credit advances, because it believes its procedure

for handling those transactions is correct. The Director, however, told us that the Agency will review the matter.

Recording Contract Costs

Title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies provides that agencies should properly account for their resources and operations. Also, the funds provided by each separate appropriation must be applied only to authorized purposes.

We reviewed 100 contract transactions at EPA's Research Triangle Park that were funded by several different appropriations. We found that 52 transactions may not have been recorded in the proper appropriation account during the 5 months ending August 31, 1984. These 52 transactions totaled $11.3 million. Based on our sample results, we project that as much as $45.4 million of $179.9 million might have been charged to the wrong appropriation accounts during the period. This accounting system weakness occurred because EPA does not require all contractors to identify on their invoices key information, such as work assignments and appropriations to be charged. When contractors submitted their invoices, EPA financial management officers were paying them by arbitrarily first using appropriated funds available for expenditure for only 1 year before using multi-year appropriated funds, or by using the oldest appropriated funds first.

EPA reported in its 1984 FMFIA report that to correct the contract cost recording and allocation problem, it plans to review contract recording practices to determine whether a relatively new recording policy is being followed. This policy, effective April 1, 1984, requires contractors to identify on their invoices the work assignments and appropriation accounts to be charged for work performed. Further, in commenting on our draft report, EPA said that it has issued a policy which requires the Agency's project officers to ensure that the correct accounting information is identified on contract invoices. EPA also said that it has obtained the services of an accounting firm to assist the Agency in its review and analysis of all contracts funded with multiple appropriations to determine whether contract costs have been properly charged.

Recovering Unspent Grant Funds

GAO's accounting principles and standards also provide that agencies are required to review the unexpended balances in their appropriation accounts at least annually to ensure that the funds are still needed for authorized expenditures. Unneeded funds are generally required to be

returned to the Treasury. Our review disclosed that EPA did not have an effective system to carry out these requirements.

Our testing at EPA's Atlanta Regional Office showed that unspent grant balances totaling over $3.8 million from fiscal years 1979 through 1984 were not properly reviewed to ensure that the funds were still needed for authorized expenditures. Therefore, the funds may not have been used for proper purposes. Our review showed that EPA's grants policy allows unspent balances to be carried over into subsequent awards to grantees. Also, the EPA Atlanta Regional Office Chief, Grant Administration, told us that EPA does not deobligate and return unspent grant balances to the Treasury because (1) EPA would not be able to reprogram the funds for later use and (2) disclosing the unspent amount would not reflect well on EPA since not all the funds appropriated for one activity—air pollution control—had been spent.

EPA reported in its 1984 FMFIA report that to correct the grant accounting problem, it plans to review its grants and financial management policies to ensure that they conform to GAO's requirements.

Recording Letter-Of-Credit Advances

Title 2 of GAO's manual requires agencies to record as advances any letter-of-credit payments to grantees in advance of work performed until evidence of performance is received. Furthermore, when grantees submit quarterly cash transaction reports, the advances should be liquidated and expenditures recorded. However, EPA improperly records letter-of-credit payments as expenditures instead of properly recording them as advances. Our review at one EPA regional office showed that, as a result, the office

- understated air pollution control grant expenditures by almost $500,000 in 1980 and overstated actual expenditures by almost $800,000 in 1981,
- lost accountability for about $70,000 in advances to grantees, and
- allowed grantees to maintain excessive balances of federal money that cost the federal government over $109,000 in lost interest.

EPA chose not to report the letter-of-credit recording problem in its 1984 FMFIA report. EPA believes that its recording procedure is correct because its accounting system allows the payments to be recorded as expenditures based on the assumption that grantees spend the funds shortly after receipt. Our review, however, showed that 19 of the 26 grantees we reviewed did not always spend the federal funds shortly after receipt, but received over $1.3 million in excess cash that was held an

average of 318 days before disbursement (see app. I). When funds are disbursed prematurely, the Treasury loses the opportunity to keep the funds in interest-bearing bank accounts.

The EPA Director, Financial Management Division, subsequently acknowledged that a problem exists since some grantees are not spending the federal funds shortly after receipt. He told us that the Agency had plans to review the extent of grantees not spending the funds.

Need to Sufficiently Address Important Principles, Standards, and Related Requirements in System Compliance Evaluation

EPA's evaluation of its financial management system was not complete. Our review of the questionnaire that the EPA accountant used to determine whether the Agency's accounting system conformed showed that he did not sufficiently address certain important principles and standards. Specifically, he did not answer questions regarding 25 principles and standards covering property acquisition, disposal, and depreciation and contingent liabilities. The accountant told us that he did not respond to all principles and standards because he did not know whether some were applicable to EPA or whether the Agency conformed.

We believe that agencies need to determine whether their accounting systems conform with key GAO accounting principles and standards. A comparison of an agency's accounting system and operations with GAO's principles, standards, and related requirements is an essential, minimum step for an agency to determine conformance. Also, this is a necessary step to design the type of effective testing program discussed earlier.

In instances where questionnaires are used, agency reviewers should respond to all questions. If the reviewer knows the answers, the answers should be noted on the questionnaire along with the basis for the response, such as personal knowledge, review of policies and procedures, or review and testing of the system in operation. If the reviewer does not know the answers, this should also be noted on the questionnaire because potential system problems may exist that require management's attention. This information can serve as the base on which to plan future reviews, thereby saving time and promoting continuity from one year to the next. Also, such information provides managers with a means to assess the scope and quality of the work performed.

Need to Include OIG Reports in the Section 4 Review Process

OIG audit reports, which often cover accounting issues, are a valuable source of information that should be used in an agency's section 4 conformance determination. They can serve to identify accounting weaknesses and to review the effectiveness of actions taken to correct previously identified accounting weaknesses. However, except for the OIG's September 1984 payroll report, we were unable to determine the extent to which EPA used OIG reports to identify whether existing problems had been corrected. The accountant who conducted the Agency's section 4 review told us that he reviewed some OIG reports as part of the Financial Management Division's work on section 2 of the act but was unable to identify any other reports reviewed as part of the section 4 work.

OIG issued 26 audit reports between October 1, 1982, and September 30, 1984, that cite problems in four key accounting areas: contract cost allocation, documentation of contract costs, accounts receivable, and unliquidated obligations.

We used OIG reports in determining aspects of the accounting system to test for conformance. Our test results show the contract cost recording problem, which the OIG identified in December 1982, remained uncorrected. This problem would not have been reported in the agency's 1984 FMFIA report had we not brought the matter to EPA's attention.

OIG's Role in Accounting System Evaluations

As with internal control evaluations, the OIG's experience and expertise enables it to play an important role in EPA's accounting system evaluations. Yet, the OIG has had only limited involvement in the Agency's accounting system evaluation process. In 1983, the OIG held discussions with EPA officials on the review process, examined selected documentation, and reported to the Administrator that the Agency's efforts were reasonable. In 1984, the OIG did not review EPA's accounting system evaluations process because it sought to avoid duplicating GAO's review efforts.

OMB has encouraged OIG participation in the Agencies' accounting systems review process. In its December 1984 Circular A-127 on financial management systems, OMB states that the OIG should provide technical assistance and advice in this area. In addition, the circular provides that the OIG should advise the Agency heads whether the financial management system review has been conducted according to the OMB guidelines.

We believe that EPA management should make greater use of OIG's experience and expertise in future accounting system evaluations. EPA's Assistant Inspector General for Management and Technical Assistance told us that the OIG staff would be willing to review and comment on the completeness and correctness of the test methodology being developed for the Agency's review of its accounting system.

Conclusions

EPA made progress in implementing section 4 of the act. EPA has identified major accounting subsystems, action has been initiated to correct the deficiencies identified in 1983, and plans have been developed to address the problems identified in 1984.

However, our review disclosed that the Administrator did not have an adequate basis to report that EPA's accounting system is in conformance with the Comptroller General's principles, standards, and related requirements. Additional action must be implemented before EPA can demonstrate that its system conforms. Specifically, we believe (1) a formal plan, including policies and procedures, needs to be developed on how the Agency is to implement section 4 of the act, (2) the accounting system needs to be reviewed and tested in operation to determine conformance with all critical Comptroller General principles, standards, and related requirements, and (3) OIG reports should be included in the section 4 review process. Also, we believe that EPA should have disclosed in its 1984 FMFIA report the letter-of-credit recording weakness we brought to its attention. We also encourage EPA officials to work with the Inspector General to involve his office more in the EPA section 4 evaluation process.

Recommendations to the Administrator, EPA

We recommend that the EPA Administrator not report that the Agency's accounting system is in conformance with the Comptroller General's principles, standards, and related requirements until the system has been adequately evaluated while in operation. To ensure that the accounting system evaluation made under FMFIA is thorough and comprehensive, we recommend further that the EPA Administrator

- establish and implement a formal plan, including policies and procedures, on how the Agency will implement section 4. The plan should include requirements for (1) reviewing and testing the Financial Management System in operation to determine conformance with the Agency's policies and procedures and the Comptroller General's requirements and (2) using OIG-reported accounting system weaknesses to

determine whether planned actions have been implemented and whether they resolve the reported problems and
- properly record letter-of-credit payments.

Agency Comments

EPA disagreed with our recommendations. Specifically, EPA believed that (1) the accounting system review performed in fiscal year 1984 provided an adequate basis for reasonable assurance and (2) the letter-of-credit payments were properly recorded.

EPA indicated that it used questionnaires, checklists, and onsite management assistance reviews which included limited transaction testing in its accounting system evaluation process. EPA also said that it obtained certifications from each financial management office as to the adequacy of the internal controls and adherence to accounting policies. EPA believed that this information provided a reasonable basis that its accounting system was in conformance with the Comptroller General's requirements.

We believe that EPA did not have an adequate basis for reporting that its accounting system is in conformance with the Comptroller General's requirements, because the Agency had not conducted sufficient analysis and testing to make this determination. As we discussed in this chapter, EPA did not (1) develop a formal plan, including policies and procedures to implement section 4, (2) operationally test its accounting system for conformance, (3) report a known material accounting system weakness regarding the Agency's improper recording of letter-of-credit advances, (4) sufficiently address important principles and standards in its accounting system compliance evaluation, and (5) systematically consider OIG reports in the section 4 review process.

Regarding EPA's letter-of-credit drawdown, EPA said that we failed to point out that the accounting procedures which it is following for recording letter-of-credit drawdowns as an expenditure were contained in the accounting system design which we approved in September 1977. EPA also indicated that our review of the Agency's letter-of-credit accounting procedures was based on the revised version of title 2, which was issued in November 1984, after the Agency had completed its section 4 review. EPA also said that it is preparing a letter to OMB to seek guidance on the application of the accounting standard as provided in OMB Circular A-127.

We used the old title 2 in reviewing EPA's credit drawdowns. Both the old and revised title 2 require agencies to record as advances any letter-of-credit payments to grantees in advance of work performed until evidence of performance is received. Our review showed that EPA improperly records letter-of-credit payments as expenditures instead of properly recording them as advances. This was because EPA assumes that the grantees spend the funds shortly after receipt. Our review, however, showed that the grantees did not always spend the funds shortly after receipt. We have explained to personnel within EPA's Financial Management Division that the Agency's letter-of-credit recording procedure did not provide sufficient control over funds provided grantees. Our review, for example, showed that EPA's Atlanta Financial Management Office could not account for $69,556 to a local government grantee. EPA did not know that the funds had not been spent since it had recorded the letter-of-credit payments as expenditures and had closed out the grant.

GAO Section 4 Test Methodology and Results

This appendix describes how we tested contract and grant transactions at two EPA financial management offices to determine whether its accounting system operated according to established accounting principles and standards and whether certain OIG-reported weaknesses had been corrected. This appendix also describes the results of our testing.

Test Methodology

We reviewed a scientifically selected sample of contract transactions at EPA's Research Triangle Park, North Carolina, Financial Management Office to determine whether contract costs were being charged to the proper appropriation accounts. EPA makes contract payments based on vouchers supported by information retained in Agency files at Research Triangle Park. As table I.1 shows, we stratified vouchers by value and selected a random sample of 242 vouchers from a total of 5,888 processed between April 1, 1984, and August 31, 1984.

Table I.1: Number of Vouchers in the Universe and Sample Tested by GAO[a] (Apr. 1 to Aug. 31, 1984)

Dollar range of stratification		Universe		Sample	
Low	High	Number of payments	Value	Number of payments	Value
$100,001	$1,000,000	331	$ 97,851,435	86	$27,838,992
20,001	100,000	1,332	58,132,018	106	4,757,929
1	20,000	4,225	23,950,987	50	246,937
Total		**5,888**	**$179,934,440**	**242**	**$32,843,858**

[a]We compared the appropriation accounts charged in the accounting records to task and work assignment information shown on the voucher from the contractor and project officer.

Additionally, at the EPA Atlanta Regional Office's Financial Management Office, we reviewed payments and accounting for all air pollution control grants issued during fiscal years 1979 through 1984 to determine whether unliquidated or unexpended grant balances (the difference between the amount of the grant award and the amount actually obligated by a grantee) were being used after the funding period ended or were being returned to the Treasury. We also reviewed these grants to determine the effect of EPA's policy of recording letter-of-credit payments as expenditures instead of advances.

Contract Payments Charged to Wrong Appropriation Accounts

In December 1982 the OIG reported to the Director of EPA's Research Triangle Park Financial Management Office that the office had been funding some contracts by improperly charging several appropriation accounts. In its review, OIG did not accept $25.6 million of $58.4 million as valid claims because contractor invoices did not specify the appropriations to be charged. In response to the OIG report, EPA required contractors, on new contracts signed after April 1, 1984, to summarize on their invoices amounts claimed for each work assignment and appropriation. The policy change did not apply to existing contracts.

Our testing at Research Triangle Park disclosed that contract payments may still not be recorded in the proper appropriation account. As table I.2 shows, we were unable to determine whether $11.3 million in contract payments were charged to the proper account during the 5-month period ending August 31, 1984.

Table I.2: GAO Test Results—Recording Payments To Appropriation Accounts[a] (Apr. 1 to Aug. 31, 1984)

Dollar range of stratification		Single appropriation contract payments		Multiple appropriation contract payments			
				Charged against correct appropriation		Appropriation charge not determinable[b]	
Low	High	Payments	Value	Payments	Value	Payments	Value
$100,001	$1,000,000	43	$13,607,558	11	$3,610,622	32	$10,620,812
20,001	100,000	65	3,004,754	25	1,088,995	16	644,180
1	20,000	34	144,590	12	64,517	4	37,830
Total		**142**	**$16,756,902**	**48**	**$4,764,134**	**52**	**$11,302,822**

[a]Based on our sample results, we estimate that about $45.4 million of $179.9 million, or 25.2 percent, may have been charged to the wrong appropriation account during the 5-month period ending August 31, 1984.

[b]The contractor invoices did not specify the appropriation account to be charged. Thus, we could not determine if contract payments were charged to the proper appropriation account.

Unspent Grant Balances Not Returned to the Treasury

Our testing at the EPA Atlanta Regional Office showed that unexpended air pollution control grant balances totaling over $3.9 million from 1979 through 1984 were not properly reviewed to ensure the funds were still needed for authorized expenditures. EPA allowed unexpended grant balances to be used after the appropriation availability period ended. In some cases, unexpended balances were included in grants several years after the appropriation availability period ended. Therefore, they may not have been used for proper purposes. For example, as table I.3 shows, we found that 1979 grant funds were carried forward for use in 1980 through 1984.

Table I.3: Funds Used by EPA's Atlanta Regional Office to Finance Air Pollution Control Grants—Grant Years 1979 through 1984

Grant Year	Funds carried forward from prior years					Current fiscal year funds	Total value of grants
	1979	1980	1981	1982	1983		
1979						$10,773,522	$10,827,777
1980	$893,788					11,331,427	12,395,778
1981	38,909	$399,195				11,975,293	12,448,783
1982	9,656	458,194	$266,035			11,520,266	12,313,981
1983	34,715		460,299	$212,521		11,342,516	12,050,051
1984	32,643		1,456	253,958	$324,514	11,219,693	11,835,651

Furthermore, EPA allowed grantees to use most unexpended funds in subsequent fiscal years instead of returning these funds to the Treasury. We also found that while unexpended grant balances totaled over $3.9 million between the end of fiscal years 1979 through 1984, only $114,344 had been returned to the Treasury. The $3.8 million difference should have been reviewed to ensure the funds were still needed for authorized expenditures before being carried forward for future use.

Improper Accounting and Control of Letter-Of-Credit Advances

We found that air pollution control grant payments at EPA's Atlanta Financial Management Office were improperly recorded as expenditures instead of advances. By recording payments as expenditures rather than advances, we believe EPA has misstated its actual air pollution control grant expenditures, lost accountability of funds, and allowed grantees to maintain excessive cash balances.

EPA has in some years understated the actual expenditures of air pollution control grant appropriations and in other years overstated the actual expenditure. For example, as table I.4 shows, EPA's Atlanta office overstated fiscal year 1981 expenditures by $788,954.

Table I.4: Grant Amounts Spent and Reported by EPA's Atlanta Regional Office—Fiscal Years 1979 through 1984

Fiscal year	Total value of grants	Amount grantees spent[a]	Amount EPA reported as spent in accounting records	Difference between amount spent and amount reported
1979[b]	$ 9,555,343	$ 8,652,158	$ 9,380,970	$728,812
1980[b]	11,005,881	10,119,697	9,637,136	[482,561]
1981	12,448,783	11,722,449	12,511,403	788,954
1982	12,313,981	11,840,753	11,502,340	[338,413]
1983	12,050,051	11,652,938	11,512,984	[139,954]
1984[c]				

[a]Grant amounts spent were reported by the grantees on their annual financial status reports.

[b]Does not include North Carolina's grant because EPA computer printout of grants omitted this state.

[c]1984 information is not included because a number of grantees had not reported to EPA during our review.

Second, EPA's Atlanta office could not account for funds totaling about $70,000 because it recorded letter-of-credit payments as expenditures. Most of these funds were advanced to one local government grantee, which received a total of $69,556 on 2 days in February 1980. EPA recorded the payments as expenditures. As of January 23, 1985, the grantee had not reported to EPA how, when, or if it had used the funds. Since EPA had recorded the letter-of-credit payments as expenditures and had closed out the grant, EPA's Atlanta Financial Management Office did not know that the funds had not been spent and had lost accountability for the $69,556. In March 1985 the EPA Atlanta office Chief, Grants Administration, told us that this grantee which has been receiving a recurring annual grant from EPA has been notified that it should submit a proposal on how it plans to use the funds during fiscal year 1985. If the funds are not to be used, the Atlanta office plans to use the $69,556 to partially fund the grantee's fiscal year 1986 grant.

Third, our testing at EPA's Atlanta office disclosed that grantees are getting federal funds in advance of their needs and contrary to Treasury regulations. EPA's Atlanta office awarded 150 air pollution control grants to 26 state and county grantees during fiscal years 1979 through 1984. EPA did not maintain records showing when grantee funds were disbursed as opposed to when they were received because EPA recorded

advances as expenditures. Therefore, we were unable to compute total excess cash balances and estimated cost to the Treasury in lost interest income. However, our testing showed that 19 grantees received over $1.3 million in excess cash that was held an average of 318 days before disbursement. At a 10-percent interest rate, this excess cash cost the Treasury over $109,000 in lost interest income.

Advance Comments From the United States Environmental Protection Agency

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

SEP 25 1985

OFFICE OF
POLICY, PLANNING AND EVALUATION

Mr. J. Dexter Peach
Director
Resources, Community and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We appreciate the opportunity to comment on GAO's draft report, "The Environmental Protection Agency's Implementation of the Federal Managers' Financial Integrity Act." We also want to take this occasion to thank GAO for recognizing EPA's commitment to this effort and the progress that we have made in improving our implementation of the FMFIA.

We feel we have made considerable progress in implementing the FMFIA since passage in 1982. We have made an extensive investment in training employees on their responsibilities under the Act and in establishing a process for evaluating and reporting on our internal control systems in accordance with OMB guidelines and GAO standards. We believe in the Act's thrust to identify, remedy and report on internal control and accounting system problems. Implementation of the FMFIA has been and will remain a high priority within EPA.

We fully support the main intent of GAO's report which will aid us in strengthening our FMFIA program. In addition, the President's Council on Management Improvement (PCMI) is analyzing the paperwork requirements of the FMFIA and will be issuing recommendations this fall. We want to design and implement a program meeting your suggestions and the recommendations of the PCMI.

We feel many of the recommendations in the draft report will help strengthen our implementation of the FMFIA. In fact, we have already taken steps in 1985 to implement many of the recommendations in the report. However, we do have serious concerns and disagreements with many of the conclusions contained

in GAO's report. Five major concerns we have with the report are as follows:

See comment 1.

1. We strongly believe that the Administrator had an adequate basis for reporting that he had reasonable assurance on the internal control systems taken as a whole.

See comment 2.

2. We are concerned about the additional paperwork burden which would result from implementing some of GAO's recommendations, such as additional segmentation of assessable units.

See comment 3.

3. We believe our approach of reviewing a program's overall internal controls is sound, as opposed to GAO's approach to identifying limited problem areas in particular operating programs.

See comment 4.

4. We feel that some of the GAO criticisms contradict or do not take into account existing OMB and GAO guidance.

See comment 5.

5. Finally, the report contains several statements with which we disagree, the more significant of which are addressed in the enclosed comments.

The enclosure to this letter provides detailed comments concerning the draft report. We would like to have this letter (including the enclosure) included in the final audit report.

We would be happy to discuss this draft report and our response further with you if you wish.

Sincerely yours,

John McGuire for

Milton Russell
Assistant Administrator
for Policy, Planning and Evaluation

Enclosure

COMMENTS ON DRAFT AUDIT REPORT

"The Environmental Protection Agency's Implementation of the Federal Managers' Financial Integrity Act"

(GAO/RCED-85-165)

See comment 6.
Now on pp. 14-24.

Chapter 2, Pages 9-21

EPA BELIEVES THE ADMINISTRATOR DID HAVE AN ADEQUATE BASIS FOR REPORTING THAT HE HAD REASONABLE ASSURANCE THAT THE INTERNAL CONTROL SYSTEMS, TAKEN AS A WHOLE, ACHIEVED THE STATUTORY OBJECTIVES OF THE FMFIA.

GAO's overall conclusion is based on the four following assumptions.

1. The extent of material weakness areas at EPA is substantial.

2. The EPA annual report is not complete.

3. The effectiveness of EPA's FMFIA process was limited.

4. The EPA does not have an adequate basis for providing reasonable assurance on its accounting system.

We disagree with GAO's assumptions that allows them to conclude that the Administrator could not give reasonable assurance. The following comments on each of the above assumptions comprise our reasons for this disagreement.

See comment 7.
Now on p. 15.

1. EPA believes it has adequate internal controls in place and the extent of material weakness areas at EPA are not substantial. (Page 11)

GAO uses the Construction Grants Program as its prime example in reaching this conclusion.

In the 1983 and 1984 assurance letters to the President and Congress, EPA referenced this program and mentioned limited areas in the program where the Agency would work to improve its internal controls. GAO makes the assumption based on this that internal controls in the entire program are deficient.

It is our opinion that the Construction Grants Program, taken as a whole, has adequate internal controls as defined by OMB guidelines. At the same time, however, we believe that this program has extensive inherent risk because of its nature and size and, therefore, material weaknesses could exist. Therefore, we will continue to review and improve our internal controls over this program.

I would also like to emphasize that EPA has viewed the issues identified in this program in the past as opportunities for internal control improvements. We have used the FMFIA as a basis for strengthening existing controls in this program. For example, the improvements reported in 1984 were:

- Monitor State priority system and priority list funding decisions.
- Increase efforts to prevent high-cost, problem projects and encourage cheaper alternatives by informing State personnel concerning technology developments.
- Increase efforts to prepare communities to support the increasing costs of building, operating, and replacing a treatment facility.
- Improve use of value engineering analysis to stretch grant funds by increasing available information.
- Tighten procedures and instruct other levels of management in fraud prevention during project design specifying and bidding period.
- Work with States to develop and implement new management methods.
- Increase EPA and grantee protection from loss by improving control over claims and change orders.

We have the same concerns regarding the other examples GAO used for this conclusion.

See comment 8.
Now on p. 17.

2. EPA's 1984 annual report was complete and complied with OMB guidance. (Page 14)

We disagree with GAO's conclusion that EPA's 1984 annual report was not complete. GAO makes this assumption because EPA did not report to the President as material weaknesses three areas which GAO believes should have been reported. These involve specific Superfund and RCRA issues listed in the 1983 report but not repeated in the 1984 report, and Agency ADP operations.

I would like to emphasize that EPA's 1984 evaluation process disclosed over 175 areas where management controls could possibly be strengthened. We followed guidance provided by OMB in determining which items should be reported to the President and Congress, and based on this guidance determined that the issues raised here by GAO were not of sufficient magnitude to report to the President and Congress.

The OMB guidance gives agencies a great deal of flexibility in deciding what items should be reported to the President and Congress. We followed the OMB guidance and we feel that it is unreasonable for GAO to criticize EPA for what is not included in the annual report.

Another important fact is that the three items which GAO indicates were not included in the annual report to the President are included in EPA's internal control tracking system and either are being addressed or have been addressed. In our opinion, the most important issue here is the identification, tracking, and correction of material weaknesses, not the issue of what is or what is not to be included in an agency's annual report.

We have the following comments regarding the issues which GAO said should have been included in the 1984 assurance letter.

Now on p. 18.

A. Superfund (Page 14)

GAO indicated that EPA's 1984 report should have included (1) material weaknesses identified in the 1983 report which were not fully corrected in 1984 and (2) Superfund issues identified in a recent GAO report summarizing GAO's work on the Superfund program.

We agree that the weaknesses identified in the 1983 report were not fully corrected. However, we believe significant progress was made in 1984 in correcting these weaknesses. As a result, 1983 weaknesses did not, in our opinion and based on the OMB guidance, warrant reporting to the President again in 1984.

The Office for Solid Waste and Emergency Response (OSWER) indicated in their 1984 report that most operational responsibility was delegated to the Regional Offices and that major guidance packages for feasibility studies, remedial investigations, and removal actions had been issued or were nearly completed. Also, a major revision of the National Contingency Plan would soon be completed, which would further strengthen internal controls.

Even though the weaknesses not completed in 1983 were not included in the letter to the President, they were reported and tracked in 1984 in the Agency's internal tracking system.

The second basis for this GAO conclusion on Superfund is a recent GAO report entitled, "Cleaning Up Hazardous Wastes: An Overview of Superfund Reauthorization Issues," GAO/RCED-85-69. This report discusses major issues facing the Congress in deliberating reauthorization of the Superfund program. In analyzing these issues, GAO drew upon information developed in a series of 23 GAO reports on hazardous waste.

The 23 reports cited go back to September 1981. GAO does not mention in the draft report that many of the recommendations made by GAO in these 23 reports have been implemented by the Agency. For example, OSWER indicated in their 1984 assurance letter that GAO findings after audits of the National Priorities List (NPL) development process were corrected. Inaccurate scores for candidate sites and bad criteria used to develop the predecessor Interim Priorities list were early procedural problems corrected by training regional and State personnel in use of the Hazard Ranking System, which generates the scores for candidate sites. A quality assurance procedure was also implemented.

Now on p. 19.

B. RCRA Program (Page 16)

As indicated in the GAO report, RCRA was included in the Administrator's report to the President in 1983 and 1984. The difference between the two years is that in its 1984 report, the Agency emphasized internal control issues resulting from implementation of the 1984 RCRA Amendments. GAO argues that items related to the RCRA program which were included in the 1983 report had not been fully corrected, and as such should have been repeated again in 1984.

We did not include in our 1984 report the same items reported in 1983 for the following reasons.

1. The Agency had made substantial progress in correcting the weaknesses identified in 1983. As a result, we did not feel that these issues in 1984 were of the same magnitude as in 1983 and did not merit reporting to the President and Congress.

2. We do not believe the items cited in the GAO report that remain from the 1983 annual report materially impact the program. That is, the development of standards and guidance cited by GAO as incomplete are necessary and good but, given the definition of internal control, needed improvements in such standards and guidance in themselves do not constitute a major material weakness.

3. Finally, OMB guidance does not require continued reporting of items in the letter to the President until full completion of corrective actions. As a result, we feel that it is unreasonable to criticize EPA for this.

I would like to emphasize again that even though these issues were not referenced in the letter to the President, these issues are included and tracked in our internal Agency tracking system until they are fully implemented.

Now on p. 19.

C. ADP Activities (Page 17)

We disagree with GAO's statement that weaknesses identified in ADP activities should have been reported to the President.

During our vulnerability assessment exercise in 1984, and in the course of other internal control activities in 1984, we identified a number of weaknesses in the ADP area. These weaknesses were recorded in our internal tracking system and are now being addressed.

However, based on OMB guidance, we determined that the weaknesses were not of sufficient magnitude to report to the President and Congress.

The examples cited in the GAO report to support that ADP should have been included are somewhat misleading. Individual problems in one program or several programs do not necessarily constitute a major material weakness. We believe we have given ADP the appropriate attention in our 1984 annual report. The examples cited by GAO do raise concerns about the efficient, economical, and effective use of ADP resources but, in our opinion, are not sufficient to say ADP is a material weakness.

See comment 9.
Now on p. 21.

3. The FMFIA process is firmly established in EPA. (Page 19)

GAO's conclusion that EPA did not organizationally and functionally establish the FMFIA process throughout the Agency is incorrect.

GAO cites the three-member Headquarters project team and indicates that this team "lacks adequate program and operating level input at the program manager level." GAO also states that regional program activity was not properly segmented or assessed for vulnerability. These statements are totally incorrect and very misleading for the following reasons.

- EPA Order 1000.24, "Establishing, Evaluating, and Reporting on Internal Control Systems," clearly establishes responsibilities for program and regional managers throughout the Agency in evaluating, reporting, and improving their internal control systems.

- Each major program, region, and other office in the Agency has a designated internal control coordinator who monitors and directs the FMFIA activities within that office. These 22 coordinators provide the necessary program and operating level input at the program manager level. They plan, document, and report on their office's FMFIA activities.

° Ninety-six assessable units have been established throughout the Agency to segment the Agency for evaluation and vulnerability assessments.

With regard to the vulnerability assessments (VA), a VA report was prepared by each regional and national program office covering the functions and assessable units in that office. The results of the regional VA's were included in the reports to national assessable unit (AU) managers. Each AU manager was properly notified of regional issues in their functional areas.

Finally, GAO mentions that some identified medium and highly vulnerable areas were not scheduled for internal control reviews. Again, this conclusion is erroneous and misleading since OMB guidance indicates that there are many other ways of addressing high or medium vulnerable areas -- such as requesting an audit, performing a management study, etc.

We agree that our process can be improved and streamlined, but we totally disagree that "EPA did not organizationally and functionally establish the FMFIA process throughout the Agency."

See comment 10.

4. EPA has an adequate basis for providing reasonable assurance on its accounting system.

See our responses to Chapter 4 of the draft report.

Now on pp. 44-57

Chapter 3, Pages 22-45

See comment 11.
Now on p. 40.

1. The Office of Inspector General was involved substantially with EPA's FMFIA process. (Page 22)

We disagree with GAO's statement that the Office of Inspector General had only limited involvement in EPA's FMFIA process. In fiscal years 1984 and 1985, the Office of Audit performed extensive audits of EPA's implementation of FMFIA and made recommendations for improving the Agency's internal and administrative controls process. Our latest report was issued on August 5, 1985. Because of the magnitude of our recommendations and the time needed by the Agency to implement our recommendations, the Office of Audit plans to do periodic reviews, not detailed reviews each year. FMFIA is one of many statutes which require OIG involvement and OIG will continue to give FMFIA its share of audit coverage, along with the other statutes in the future.

See comment 12.
Now on p. 26.

2. EPA's segmentation was adequate in 1984. (Page 23)

We disagree with GAO's recommendation that EPA should require additional segmentation. The assumption that smaller units would result in more efficient and effective evaluations is inaccurate.

The basis for having assessable units is to perform vulnerability assessments (VA). The VA does not identify weaknesses, but as indicated in the OMB guidelines:

> "... are the mechanism with which an agency can determine the relative potential for loss in these programs and functions, and then, after giving consideration to such relevant factors as management priorities, resource constraints, etc., schedule internal control reviews and related actions."

EPA segmented according to activities based on the Agency's budget structure to ensure, as OMB requires, that all activities be assessed. To ensure meaningful assessments, local operating managers analyzed their specific operations' various geographical locations and reported their conclusions to the national program manager, who as assessable unit manager was responsible for rating the vulnerability of the function. In this way, risks in a specific activity Agency-wide could be considered in their totality. The EPA process is based on the idea that the national program manager is in the best position to determine whether deficiencies, if any, are Agency-wide or localized and that the national program manager, together with the local manager, is best placed to devise appropriate solutions.

OMB suggests that taking a sample of activities conducted in multiple locations would suffice. EPA exceeded the OMB guidelines by incorporating the analyses of managers from all 10 regions in the vulnerability assessment reports issued by the national program managers.

Even if managers failed to review each and every activity carried out in each assessable unit, creation of smaller assessable units would not be an appropriate or satisfactory solution. A more efficient and direct solution would be to note specific deficiencies and encourage correction. Future Agency guidance will remind all managers of the need to analyze all activities.

Regarding segmentation at EPA, the last paragraph on page 24 states that EPA laboratories were not adequately considered in the segmentation process. This paragraph indicates that EPA has over 30 research and development laboratories located throughout the country. The Agency may have a total of 30 laboratories, if all operations outside headquarters are counted; however, the Office of Research and Development (ORD) has 14 laboratories. While those laboratories were not identified as separate assessable units, all their functions were incorporated into other ORD assessable units. EPA is now evaluating the appropriateness of having each ORD laboratory identified as a separate assessable unit, as suggested by the report.

See comment 13.
Now on p. 28.

3. Program managers were fully involved in the VA process. (Page 25)

EPA managers were involved in the VA process. The GAO report assumes that because the Headquarters internal control team interviewed managers, gathered data, and drafted the initial VA that managers were not involved. The Headquarters internal control team only provided administrative support to the AU managers for preparation of the VA's. All decisions relative to the vulnerability of the AU were provided by the AU managers themselves. The VA was the product and responsibility of each AU manager. Each manager was totally responsible for the final VA and what was included in the VA report. Most importantly, the VA was signed by each assessable unit manager, not by the Headquarters internal control team. Again, the Headquarters team was responsible only for providing administrative support.

The GAO report also states that for the most part, VA's were not done at the levels at which EPA programs are operating -- in regional and field locations. We also disagree with this conclusion. Each region program office was involved extensively in the VA process and a comprehensive VA report was prepared for each Regional Office. The results of the regional VA's were included in the VA's for each national program office. Each national program office was thereby aware of regional and field issues affecting their programs.

In addition, we feel that GAO has made several inaccurate or misleading statements in this section. Our comments to specific paragraphs follow.

See comment 14.
Now on p. 28.

- Page 25, paragraph 4. The GAO statement that "EPA did not fully involve program managers in the VA process" is inaccurate. The program manager was totally responsible for the VA. The ICPT only relieved the program manager of the administrative burden.

See comment 15.
Now on p. 28.

- Page 26, paragraph 1. The program managers' role was more than to review assessments. In addition, they were interviewed about their operations, asked specific questions, provided supporting documentation, and made the decision on their vulnerability. The GAO report should clarify that program managers did more than review assessments.

See comment 16.
Now on p. 29.

- Page 26, paragraph 2. The VA process is to determine susceptibility to fraud, waste, or loss. Once this is determined, the EPA can evaluate operations conducted in the field. Each Regional Office does not have to be evaluated to determine vulnerability.

See comment 17.
Now on p. 29.

- Page 26, paragraph 3. GAO should indicate that EPA officials were interviewed and other correspondence was reviewed to determine how EPA performed the assessments.

See comment 18.
Now on pp. 29-30.

- Page 27, paragraph 3. The ICPT used one assessable unit for ADP operations. A VA was performed on the ADP facilities, equipment, operations, security, etc. In addition, each assessable unit manager was asked about his ADP operations. What we found is that ADP was considered immaterial to the overall program operations. The GAO implies some additional criteria should be used for ADP activities.

See comment 19.
Now on p. 30.

- Page 28, paragraph 3. The Construction Grants Program was identified as a material weakness in 1984 and considered a vulnerable area. The Agency saw little to gain by assessing regional operations.

See comment 20.
Now on pp. 30-31.

- Page 29, paragraph 2. The GAO recognizes alternatives exist to the ICR, but the emphasis is on the ICR and the approach to performing the ICR's. We feel balance should be given to the alternative actions.

See comment 21.
Now on p. 32.

- Page 31, paragraph 3. The draft report cites an ICR on EPA Headquarters environmental impact statement preparation under the Clean Air Act. We believe this paragraph is not accurate. We believe all of the control techniques were reviewed. We suggest you review the ICR again.

See comment 22.
Now on p. 35.

4. EPA's tracking and follow-up system ensures corrective actions are made in a timely manner. (Page 35)

The GAO concludes that our tracking system was not complete because GAO was given an interim report. We agree we had not entered all weaknesses into our tracking system, but this does not imply that EPA is not taking corrective action.

The criteria used by GAO states that "completing VAs and ICRs is not an end in itself, but that determining, scheduling, and taking the necessary corrective actions as promptly and timely as possible is critical." Each program that identified weaknesses prepared a corrective action plan that identified the steps and timeframe for completing an action. The tracking system is only an administrative tool for tracking the progress of these actions.

Also, GAO indicates that the ICPT should not delete weaknesses from the system before "the ICPT has tested or verified that they have in fact been adequately corrected." We disagree with this statement. GAO does not cite criteria requiring an agency to test or verify that weaknesses have been adequately corrected. We feel that managers are responsible for this and that other traditional methods such as GAO and IG audits or management reviews will determine the adequacy of corrective actions.

See comment 23.
Now on pp. 40-41.

5. EPA's Office of Inspector General plays an active role in achieving FMFIA goals. (Pages 42 and 43)

EPA diagress with the report's statement indicating that the Office of Inspector General could be more involved in achieving FMFIA goals at EPA.

FMFIA is an important requirement which was intended to stimulate increased attention to all levels within EPA to strengthen internal accounting and administrative controls to prevent fraud, waste and abuse in programs, functions, and activities. It is the Agency management's responsibility to meet the Act's requirements, including (1) performing an effective evaluation of internal controls in accordance with OMB guidelines and (2) reporting to the President and the Congress on whether the system fully complies with the Act's internal control objectives and the Comptroller General standards. The role of the OIG, as defined in EPA Order 1000.24, is to (1) provide technical assistance in the Agency's effort to evaluate and improve internal controls and (2) perform audits to determine compliance with EPA guidelines.

EPA recognizes the importance of providing sound technical assistance when the Agency requests OIG assistance. However, OIG does not believe its role is to subject its judgment on or interfere with the Agency in performing its internal and administrative functions. OIG believes and the draft report supports that OIG has provided sound, timely and responsive assitance and guidance on a number of matters regarding FMFIA. Because OIG believes it is important to be involved in the FMFIA processs, OIG plans to provide technical assistance when the Agency requests OIG involvement. Also, as in the past, OIG will continue to perform our audit responsibility of evaluating and reporting on the Agency's internal controls.

See comment 24.
Now on p. 42.

6. GAO recommends that EPA fully define EPA's program managers' role in the FMFIA process with a view toward having managers be more involved in evaluating internal controls. (Page 45)

In February 1983, we issued EPA Order 1000.24, which identifies the FMFIA responsibilities of our managers. In addition, we began an extensive training program to inform managers and supervisors of their responsibilities under the Act.

Naturally, we will consider any other changes to improve and streamline the process in future years.

7. GAO recommends that EPA schedule ICR's for identified high and medium vulnerability weakness areas, where other forms of corrective actions were unsuccessful or inappropriate. (Page 45)

See comment 25.
Now on p. 42.

We agree with this recommendation to the extent that ICR's or related actions are appropriate.

The GAO fails to mention that the OMB guidance allows an agency to consider a series of options for each program and administrative function. These consist of:

- Scheduling and conducting an internal control review.
- Requesting an audit.
- Establishing increased or improved monitoring procedures.
- Developing and conducting training programs for the staff.
- Issuing clarifying instructions.
- Modifying procedures or documents.

The ICR is but one method cited in the OMB guidelines. We have used several of the suggested techniques to address the high and medium vulnerability areas.

See comment 26.

We believe the GAO report was more concerned with the form of the seven ICR's completed in EPA rather than the results of the reviews. We also believe that EPA has addressed many of the high and medium vulnerability weaknesses by related actions and management reviews.

8. GAO recommends having the FMFIA tracking system monitored and following up on all internal control weaknesses. (Page 45)

See comment 27.
Now on p. 42.

We agree with this recommendation and have already taken the appropriate steps to update the corrective action tracking system to monitor internal control weaknesses. We also follow up on all weaknesses quarterly to determine the current status of the weakness and whether corrective actions are being completed in a timely manner.

The data provided to the GAO review staff was a partial report. We had not updated the tracking system at the time of the audit. Subsequently, all weaknesses have been inputed into our automated system for tracking.

See comment 28.
Now on p. 42.

9. GAO recommends that EPA require responsible program managers in the various functional areas to validate that actions taken to correct weaknesses reported as corrected are adequate to prevent or reduce their recurrence. (Page 45)

We agree with this recommendation to the extent managers are not criticized that corrective actions did not work, but when in reality the program has changed either because of legislation, regulations, or other occurrences. We are presently complying with this recommendation.

We presently require program managers in their annual report to indicate the the corrective actions taken were appropriate.

The annual report states:

> "I will continue to review our operations carefully to make sure that the corrective actions taken were sufficient to solve the problems identified and preclude future occurrences of similar problems. If the actions do not appear sufficient, we will undertake additional corrective actions as appropriate."

Secondly, program managers are performing reviews and self-assessments other than ICR's that should evaluate corrective actions. Finally, we will continue to rely on GAO and IG reviews to evaluate the effectiveness of corrective actions.

See comment 29.
Now on p. 42.

10. GAO recommends that EPA assess FMFIA training needs and train staff as necessary. (Page 45)

We agree with this recommendation and in FY 1985 took steps to ensure that staff were trained in the FMFIA process. The Office of the Comptroller provided training to an estimated 500 managers and supervisors in Headquarters, regional, and laboratory offices. Briefings were also given to EPA's managers on their responsibilities under the Act. In addition, many offices performed their own training.

Now on pp. 44-57.
See comment 30.

Chapter 4, Pages 46-62

1. We believe the accounting system review performed in fiscal year 1984 provided an adequate basis for reasonable assurance.

The OMB guidelines recognize the use of a "limited review," employing questionnaires, checklists, and similar methodology. In addition, EPA used on-site management assistance reviews which included limited transaction testing in the evaluation process.

We obtained certifications from each financial management office as to the adequacy of the internal controls and adherence to accounting policies. We believe that this information provided a reasonable basis upon which to make our fiscal year 1984 assurance.

In addition to these general comments, we have the following specific comments which should be included in the report to clarify the statements presented.

See comment 31.
Now on p. 44.

- Page 47, paragraph 1. The text should indicate that, in addition to accounting data, property management data is entered by 18 locations in the regions, major labs, and Headquarters into a separate subsystem.

See comment 32.
Now on p. 44.

- Page 47, paragraph 2. This paragraph should also indicate that the FY 1984 report presented the status of corrective actions described in the FY 1983 report. These dealt with property management, cost accounting, and accounts payable recording procedures. The FY 1984 report indicated that the property management and cost accounting deficiencies still existed. The previously reported deficiency related to accounts payable not being reported on a monthly basis was deleted when GAO revised its accounting standards.

See comment 33.
Now on p. 46.

- Page 48, paragraph 1. It should be noted that it was not simply one accountant who conducted the Section 4 review. Rather, the Headquarters branch chiefs within the Financial Management Division (FMD) and other FMD staff were also requested to identify accounting system deficiencies. In addition, certifications provided by the Agency's financial management offices under Section 2 of FMFIA and the management assistance reviews were considered in the analysis. While one individual had the lead responsibility, others were consulted or reviewed the work products.

See comment 34.
Now on pp. 46-47.

- Page 48, paragraph 2. It is not correct to state that the payroll deficiencies were identified solely by the Inspector General report. The deficiency within the payroll system was originally identified in the FY 1983 Section 2 FMFIA report of the FMD. At that time, the Agency scheduled an internal control review of the payroll function to more fully evaluate the nature of the potential problems. The review performed by the Inspector General was initiated at the request of the Office of the Comptroller. A tracking process was used by the FMD staff to assure that all the deficiencies were properly addressed. In addition, we have had the accounting firm of Arthur Young perform an independent appraisal of the adequacy of our corrective actions. Based on their analysis and our own assessment of the payroll operations, the corrective actions taken and planned will correct the deficiencies noted.

See comment 35.
Now on p. 46.

- Page 49, paragraph 4. The exact nature of the integration of property data should be fully understood. We will be having each financial management office enter transactions directly into the general ledger for funded property acquisitions meeting the new capitalization criteria specified by GAO, i.e., property items over $5,000. On a monthly basis, we shall extract data from the personal property accounting system for comparison with the data recorded in the Agency's Financial Management System. The reconciliation differences will be researched and corrective entries will be subsequently entered into the applicable system. This integration will improve the accuracy of property amounts reflected in the Agency general ledger accounts for property items over $5,000.

  Our analysis of the property management records indicates that problems exist in the accuracy and completeness of this data. We shall continue to recognize a deficiency in the property management records. As part of our OMB Circular A-127 implementation, we have planned efforts to correct the property management records.

See comment 36.
Now on p. 47.

- Page 50, paragraph 1. The connotation in this paragraph is misleading. GAO should acknowledge that EPA obtained the services of Ernst & Whinney to evaluate its need for cost accounting data as a result of the Grace Commission survey. This study concluded that:

  - Management decisions would not be affected at this time by cost accounting data.
  - Cost finding techniques would serve those areas where cost data was needed, such as in fee-setting programs.
  - The Superfund program was the only program with an identifiable need for cost data on a continuous basis.

  We presented the Ernst & Whinney report findings to the representatives of the GAO and obtained their written concurrence with our use of cost finding techniques in lieu of an Agency-wide cost accounting process.

  Under the Superfund program, EPA is authorized to pay for the Government's response costs incurred in clean up of hazardous waste site/spill and to bill the responsible parties for costs incurred on a site-by-site basis. The indirect cost that will be billed to responsible parties will be determined by EPA's Office of the Comptroller through the application of a comprehensive indirect cost allocation plan developed by Ernst & Whinney.

See comment 37.
Now on p. 49.

- Page 50, paragraph 3. To put the issue of transaction testing of accounting systems into perspective, the GAO should address more fully the lack of Government-wide guidance for transaction testing. We were unable to find any standards specifying the nature of transaction testing required which were available at the time of the Section 4 review for fiscal year 1984. GAO was only able to provide us with memoranda and reports from the Comptroller General indicating that testing was required. These issuances did not specify the nature or extent of testing which the GAO considered appropriate.

  We in EPA continue to believe that, at the time of the FY 1984 FMFIA Section 4 review, inadequate guidance was available from both OMB and the GAO. The OMB issued in May 1985 "Guidelines for Evaluating Financial Management/ Accounting Systems." The guidance presented by the GAO on page 53 of this report is taken from this OMB guidance. This is the first real guidance presented on the nature of the testing expected. It is important to note that the draft of this guidance available to the agencies in September 1983 did not contain the requirement for the testing of transactions.

See comment 38.
Now on p. 50.

- Page 51, paragraph 1. The GAO draft report indicates that our letter of credit accounting procedures do not conform to the GAO principles and standards. The GAO fails to point out that the procedures which we are following for recording letter of credit drawdowns as an expenditure were contained in the accounting system design which the Comptroller General approved in September 1977. The GAO accounting principles upon which the procedure was based did not change until the new version of Title 2 was issued in November 1984, which occurred after the completion of the Section 4 review.

  During this current fiscal year, we conducted an analysis of letter of credit reporting at the Las Vegas finance office. This office handles approximately half of the Agency letters of credit. Their study showed that about 83% of the grantees are reporting negative cash on hand, indicating that the grantee expenditures are occurring prior to the grantee drawdown of Federal funds. Such reporting leads us to the conclusion that our present recording of the drawdown as an expenditure is proper under generally accepted accrual accounting concepts. We are preparing a letter to OMB to seek guidance on the application of the accounting standard as provided in OMB Circular A-127.

See comment 39.
Now on p. 46

- Page 52, paragraph 1. The GAO should recognize that the issuance of OMB Circular A-127 and the OMB accounting objectives and evaluation guidelines will be the basis for subsequent evaluations of the financial/accounting systems. The EPA has prepared and issued an EPA Order which complies with the requirements of A-127.

  In addition, the FMD has prepared a plan for its FY 1985 accounting and internal control evaluations. This plan was submitted to the EPA Inspector General for comment in March 1985. His response indicates that the plan is adequate for the performance of the fiscal year 1985 review.

See comment 40.
Now on pp. 51-52.

- Page 53, paragraph 1. GAO should recognize in its report that transaction testing will be but one means to assure conformance with the Section 4 review. The FY 1985 Section 4 analysis will use a combination of data sources. These include a certification from the financial management officers as to the adequacy of the accounting and internal controls within their offices, an audit of the Superfund program by independent auditors under the direction of the EPA Inspector General, transaction testing performed by an independent accounting firm of two finance offices, the OMB Circular A-127 limited review, the management assistance reviews, and IG and staff review reports.

See comment 41.
Now on p. 52.

- Page 55, paragraph 1. As discussed in our comment earlier, we are sending to OMB a request for a formal opinion on the correct accounting procedures pertaining to letter of credit drawdowns.

See comment 42.
Now on pp. 51-52.

- Page 56, paragraph 2. During this current fiscal year, we have taken several steps to correct contract cost recording and allocation deficiencies. We have issued a policy which requires the Agency's project officers to ensure that the correct accounting information is identified on contract invoices. We have obtained the services of Arthur Young to:

  - Assist EPA in its review and analysis of all contracts funded with multiple appropriations to determine whether contract costs have been properly charged.

  - Document necessary adjustments to EPA's payment records and the Financial Management System.

  - Provide EPA recommendations on improving the Agency's contract charging policies and procedures.

See comment 43.
Now on pp. 51-52.

- Page 56, paragraph 3. The description of the deficiency related to recovering unexpended grant funds needs to be more fully explained. The unexpended balances are those which have been obligated for an award, but are not used by the grantee by the end of the award period. Our appropriation structure generally allows the Agency to carry these funds into the following award period. GAO found, however, that in some cases these funds were not reissued until after the end of the appropriation term.

  A policy issued in 1979 applied the "bona fide need concept" to allow these funds to be used indefinitely. A recent Comptroller General decision indicates that our policy may be inappropriate. A task group has been established to evaluate the appropriateness of the current EPA policy.

  To summarize, the deficiency here is not that there is a lack of the review of unliquidated obligations at year end as characterized by GAO, but rather that EPA policy guidance may need clarification.

See comment 44.
Now on p. 53.

- Page 58, paragraph 3. The comment about the EPA accountant not addressing all the questions pertaining to property acquisition, disposals, and depreciation and contingent liabilities is misleading. Property management is not a function within the responsibility of the acountant performing the Section 4 analysis. The EPA accountant did acknowledge that the property accounting procedures are inadequate. Data entry controls in the property management process are not present to assure that all transactions are received or processed. The property accounting process uses the data from the property management system as the basis for adjusting the Agency's general ledger accounts.

See comment 45.
Now on pp. 54-55.

2. OIG had substantial involvement in EPA's accounting system evaluation process. (Page 60)

EPA does not agree with the report's statement indicating that the OIG had limited involvement in the Agency's accounting system evaluation process.

GAO's own draft report supports the premise that the OIG has been active in the accounting system evaluation process. For example, the draft report points out that in 1983 the EPA OIG met requirements similar to those required in OMB Circular A-127 issued in December 1984.

The draft report correctly states that in 1984 the OIG did not review EPA's accounting system evaluations. However, the decision not to duplicate GAO's efforts in this area was made in consultation with GAO. OIG advised GAO of our plans early in the review and discussed this exclusion in the IG's August 5, 1985 report.

The following are GAO's comments on the Environmental Protection Agency letter dated September 25, 1985.

GAO Comments

1. Discussed in Agency Comments Section Of Chapter 2.

2. While sharing EPA's concern about paperwork, GAO believes that a certain amount of documentation is essential. The key is for agencies to determine what documentation it will find useful, since documentation should be a management tool to assist in planning future work, developing meaningful corrective actions, and assuring completeness and quality of evaluations performed.

On the whole, while the act may result in documentation of internal control and accounting systems which has not been mandated in the past, much of this documentation is an essential part of good managerial procedures. Although an initial investment in paperwork may be required, once that is achieved the paperwork generated by the review process itself should not be very great. At that point managers can look at existing documentation in evaluating their systems. If past work is not documented, they will have to virtually start from square one every year.

3. We do not believe that EPA has successfully completed an adequate overall review of its internal control and accounting systems. On the contrary, we have reached the opposite view in that while EPA has made progress we do not believe it has progressed sufficiently in the FMFIA process to provide the assurances it has given in its annual reports in 1983 and 1984.

Regarding EPA's review approach, the examples of internal control and accounting systems problems identified by GAO were intended as illustrative examples to demonstrate the need for further FMFIA implementation effort and reviews on the part of EPA. The examples cited were not intended as an all inclusive prescription which when responded to by EPA will totally correct the system deficiencies we have cited.

4. None of our criticisms contradict or conflict with existing OMB and GAO guidance.

5. See chapters 2, 3, and 4 and our response to specific EPA comments on our draft report.

6. Discussed in agency comments section of chapter 2.

7. EPA's 1983 annual report acknowledged as material weakness areas the entire (1) water resources construction grants program, (2) the Resources Conservation and Recovery Act program area, and (3) the Superfund program. EPA was to have completed ICRs covering these areas. It also cited limited plans for alternative corrective actions. Neither the ICRs, nor the corrective actions planned in 1984 were adequately completed, or covered these substantial areas.

In 1984, only the construction grants area was repeated as a material weakness along with 2 other programmatic areas and 2 administrative areas. As pointed out in chapter 2, the 1984 program activities acknowledged as material weaknesses encompassed over 60 percent of EPA's total fiscal year 1985 budget.

Of EPA's fiscal year 1985 budget of $4.3 billion, $2.4 billion was for the construction grants program. Substantial parts of this program's activities remain unstudied and unresponded to in terms of corrective actions. Over 95 percent of construction grants program operations are in the regions. EPA itself in its comments to our draft report stated it had not assessed construction grants regional operations as part of the 1984 vulnerability assessment process.

8. As noted in chapter 3 of our report, EPA did not include in its annual report for 1984 the Superfund, RCRA, and ADP areas as material weaknesses, even though substantial unresolved weaknesses in internal controls remain in these areas. EPA's 1983 report acknowledged the Superfund and RCRA program areas as being in the material weakness category. ICRs were to be done in both areas in 1984 to delineate corrective actions—in the cost recovery and regional consistency in decision making area for Superfund, and on the entire RCRA program activity. Actions taken and planned by EPA in 1983 and 1984, are inadequate in view of the range of EPA acknowledged internal control management needs in both these areas. Also, 100 of the 175 weaknesses in internal controls identified in 1984 were not added to and tracked in EPA's corrective actions tracking system.

Superfund - EPA's Superfund is a $1.6 billion dollar revolving fund for hazardous waste site cleanup activity. As of August 31, 1985, EPA has disbursed about $313 million in cost reimbursable activities. EPA has succeeded in collecting back about $13.1 million through its cost recovery process from responsible parties liable for the cleanup activity.

The current EPA Administrator when he was the Assistant Administrator for Solid Waste and Emergency Response said in his 1984 annual report on internal controls that the Superfund cost recovery area was significant because EPA does not know what information should be collected to support cost recovery litigation. The Congress is currently considering expanding the fund by as much as $10 billion.

RCRA Program - Regarding RCRA, the current EPA Administrator similarly acknowledged in his input as Assistant Administrator to the 1984 annual report that EPA has not completely corrected the material weaknesses identified in the RCRA area and reported in EPA's 1983 report. In this regard, he stated in a memorandum transmitting the RCRA ICR to the former EPA Administrator that to develop this program, EPA "will need an additional several years." This program has been under development at EPA at least since 1976.

ADP Activities - EPA has 51 major ADP systems and up to 2,000 subsystems, none of which have been assessed for vulnerability as a result of the FMFIA process. Various special studies and reports have identified broad ineffectiveness in EPA ADP systems, notably in the hazardous waste and water program areas. Regions I and VII have developed parallel manual systems in the hazardous waste area because of their inability to rely on the hazardous waste data management system. Problems were also noted over the years in EPA's water programs STORET system—one of EPA's most important ADP systems. In the ADP area only the issue dealing with system security in the toxic and pesticide areas, and ADP aspects related to the payroll system were acknowledged by EPA as material weaknesses.

9. Discussed in agency comments section of chapter 3.

10. Discussed in agency comments section of chapter 4.

11. In 1984, EPA's OIG did an audit of the FMFIA process completed by EPA and provided technical assistance when asked by way of offering comments on memos or other FMFIA materials developed by the ICPT. It was not involved in (1) the segmentation of EPA programs and functions, (2) the conduct of VAs apart from the OIG area, (3) the completion of ICRs and (4) the acceptance of corrective actions, including followup and testing of the adequacy of corrective actions taken. (Also discussed in ch. 3.)

12. EPA operations are decentralized in its 10 regional offices. VAs were not done in the regions, notably on construction grants, hazardous waste activities, EPA laboratories, and Corps of Engineers and state involved EPA operations, as well as on the Great Lakes and Chesapeake Bay programs.

EPA acknowledges it segmented based solely on its budget structure. However, OMB guidance provides that agencies use eight other bases for segmenting, including agency programs, functions, and operations.

In addition, all EPA segments were headquarters oriented and each segment—all 96—had headquarters officials as responsible managers, even though regional managers are overwhelmingly charged with responsibility for regional operations.

Finally, EPA acknowledges that at least the EPA laboratories should be considered as separate segments. We believe however that other regional or delegated responsibilities throughout the agency, notably in the construction grants, hazardous waste, Corps of Engineers, state and other delegated functions, as well as other regional and local operations, should be segmented. We believe they should be assessed where these operations are taking place, not at the headquarters level as was done in 1984.

13. No regional VAs were done by EPA. EPA acknowledged in its comments that the ICPT, with regard to the vulnerability assessment process gathered the data, interviewed the program managers, and drafted the VAs. The ICPT also provided an initial draft rating for each of the VAs.

EPA's ICPT in a June 1984 memo, delineated the overall limited planned involvement in the VA process of the POHs and of program managers. That memo indicated that the ICPT will do the process with only a limited need for local and regional level input—a planned meeting of one-half to 1 hour. Suggesting that all the ICPT did was relieve an "administrative burden," in view of the process we delineated as well as memos from the ICPT describing how the ICPT was to do the process is, in our opinion, a misstatement of the process conducted by the ICPT.

Regarding alternatives to the ICR process, EPA simply has not done ICRs in many of the material weakness areas EPA acknowledged or ICRs done have not proved successful, notably in the Superfund and RCRA areas. The Clean Air Act ICR, discussed in our report, in its opening comments

acknowledges various areas appropriate to the ICR that were not covered in terms of assessing internal control techniques appropriate to the area. In our report, however, we are pointing out that testing of the revised techniques proposed as corrective actions was not done by EPA.

14. See comment 13.

15. See comment 13.

16. See comment 13.

17. See comment 13.

18. For EPA to suggest that its 51 major ADP systems with up to 2,000 subsystems are "immaterial" to EPA operations and need not be the subject of individual VAs suggests a lack of understanding of the FMFIA process. Similarly, stating that EPA saw "little to gain" in assessing regional (construction grants) operations as part of the VA process at the local level where such activities are taking place also suggests a lack of understanding of what is required by OMB guidance.

19. See comments 13 and 18.

20. See comment 13.

21. See comment 13.

22. Discussed in agency comments section of chapter 3.

23. See comment 11 and chapter 3.

24. Discussed in agency comments section of chapter 3.

25. Discussed in agency comments section of chapter 3.

26. Our report states that EPA ICRs were limited: (1) lacking in their scope and testing of internal controls, (2) numerous areas were noted where ICRs or alternatives were not done or proved ineffective, notably in the RCRA and Superfund areas, and (3) even through corrective actions were required as a result of completed ICRs, they were not made a part of the corrective actions tracking and followup system and adequately completed. Based on EPA's 1983 acknowledged internal control

weaknesses, not enough ICRs and corrective actions were undertaken by EPA.

27. Discussed in agency comments section of chapter 3.

28. Discussed in agency comments section of chapter 3.

29. Discussed in chapter 3.

30. Discussed in agency comments section of chapter 4.

31. No change to report needed.

32. No change to report needed.

33. Report amended.

34. Report amended.

35. Report amended.

36. Report amended.

37. While we recognize that OMB did not issue its Guidelines for Evaluating Financial Management/Accounting Systems until May 1985, we have explained the importance and need for transaction testing to personnel within EPA's Financial Management Division during our review. We have also suggested that EPA coordinate its testing efforts with its OIG and GAO by seeking their comments on its test program. We believe that transaction testing, in most cases, is key to determining whether an accounting system conforms. Transaction testing encompasses determining the principles, standards, and related requirements that apply to the system and processing actual and simulated transactions to verify that the applicable requirements are being met on a consistent basis. Further, our intent in this chapter was to offer additional suggestions to enable the Agency to improve its future system evaluations.

38. Discussed in agency comments section of chapter 4.

39. EPA said that we should recognize that the issuance of OMB Circular A-127 and the OMB accountability objectives and evaluation guidelines will be the basis for subsequent evaluations of the financial/accounting systems. We wish to point out that FMFIA requires agencies to report on

whether their accounting systems conform with the Comptroller General's principles, standards, and related requirements. The Comptroller General's requirements should be the basis for which agencies evaluate their accounting systems for conformance under the act, not OMB Circular A-127.

40. See comment 37.

41. Discussed in agency comments section of chapter 4.

42. Report amended.

43. GAO believes that the deficiency related to recovering unexpended grant funds may be caused in part to a need for EPA to clarify its policy guidance. However, we also believe that EPA needs to assure unliquidated obligations are reviewed at year-end to ensure the funds are still needed for authorized expenditures.

44. EPA said that our comment about the EPA accountant not addressing all the questions pertaining to property acquisition, disposals, and depreciation and contingent liabilities is misleading. EPA said that property management is not a function within the responsibility of the accountant performing the section 4 analysis. EPA also said that the accountant acknowledged that property accounting procedures were inadequate. We believe that while property management may not be a function within the responsibility of the accountant performing the section 4 analysis, EPA should ensure that these questions regarding principles and standards covering property acquisition, disposal, and depreciation are addressed.

45. We disagree. In 1983, the OIG, which held discussions with EPA officials on the review process and examined selected documentation, reported to the Administrator that it conducted a limited review of the Agency's section 4 efforts. The OIG did not review EPA's accounting system evaluation process in 1984.